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THE INTERFACE BETWEEN STABILIZATION AND SPECIAL ASSISTANCE PROGRAMS IN THE CANADIAN GRAIN SECTOR

SOME ISSUES AND MOVING TOWARD THE OPTIMAL BALANCE

Agriculture Canada

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Prepared for:

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EXECUTIVE SUMMARY

An interface exists between regular stabilization programs (ASA/WGSA) and special assistance programs (SCGP) in the Canadian grains sector. This interface was not explicitly recognized when special assistance payments to producers did not account for "net injury" (i.e., providing compensation after the stabilization payments of regular stabilization programming are accounted for).

The interface issues between regular stabilization and special assistance programs will remain until prices improve since the level of assistance from regular programs is quickly eroding, particularly when it is needed most. This erosion stems directly from the design of formulas in ASA and WGSA, where the moving five-year average of price, and margin above cash costs, are both dramatically lower as the sector remains at the bottom of a deep valley in the price cycle.

The need for special assistance, therefore, is highly related to the adequacy of the ASA/WGSA formulas. On many fronts, it became apparent that a modification of the formulas in ASA and WGSA is preferred to the option of retaining the current situation with an extremely high reliance on special assistance as regular programs become more ineffective.

Just as a formula based on 5 years of history has weaknesses when the industry moves down a price cycle, so too does a formula based on a longer historical period (e.g. 10 years) as the industry moves back up the price cycle. Additionally, unless explicitly included, a stabilization formula will not necessarily ensure that cash costs of production are returned to grain and oilseed producers.

Our suggestions on regular programs is to have built-in formula flexibility where the formula ensures a safety net to growers in

situations of high costs and also in periods of prolonged low prices. We have suggested a margin concept where the greater of a non-negative 5 and 10 year margin above cash costs is employed. Moreover, to provide cash flow when it is direly needed, the percentage of margin should increase when disaster occurs - such as when producers have had to rely on stabilization payments for three or more successive years.

Once statutory programs are modified, then the appropriate role of ad hoc special assistance can be ascertained. The main issue is whether the assistance should be to offset a short fall in statutory programming. This approach includes a compensation payment when the stabilized price is still below a safety net concept, and, as well, the need for additional premium assistance to deficit ridden stabilization funds. This helps lighten the premium load on producers. If regular programs are considered adequate, then special assistance may still be required in the form of adjustment assistance as the grain sector adjusts to a new economic reality.

1.0 INTRODUCTION

A Special Canadian Grains Program (SCGP) has been provided to the grain and oilseed sector on both the 1986 and 1987 crops. This $1 billion special assistance program was in response to the extremely low prices which have been attributed to the US/EEC trade and subsidy war. The intent of the SCGP is one that can be argued was to prevent the Canadian grain and oilseed sector from being totally side-swiped by this subsidy war, which was highlighted by the large drop in loan rates and the use of export subsidies in the 1985 U.S. farm bill.

Even though an SCGP payment was made,the grain and oilseed sector is protected against downward swings in commodity prices through the Western Grain Stabilization act (WGSA) and the Agricultural Stabilization Act (ASA).

Providing an SCGP suggests that regular stabilization programs would not have provided sufficient protection against the low 1986 and 1987 prices. However, if that was the case, then instead of an SCGP the WGSA/ASA programs could have been modified.

There are a considerable number of issues that arise when WGSA/ASA and SCGP are provided to the grain sector. Agriculture Canada commissioned DELOITTE HASKINS & SELLS to prepare this paper with the purpose of identifying and addressing these issues.

1.1 OBJECTIVES

The objectives of this paper are:

a) to identify the interface between the Special Canadian Grains Program and other existing, regular programs;
b) to identify and discuss the issues that result from this interface;
c) to provide an assessment of WGSA/ASA and SCGP using economic, political and administrative assessment criteria; and
d) to address the optimal programming balance between regular stabilization and special assistance programs.

1.2 OUTLINE OF THE REPORT

This report is organized as follows. In Chapter 2.0, the role and rationale for special assistance is discussed. Chapter 3.0 briefly outlines the programs of significance to the grains and oilseed sector. In Chapter 4.0, some concepts are discussed that involve both regular stabilization and special assistance. These include the difference between safety nets, price stabilization and price supports. Special assistance as compensation or as adjustment assistance is also addressed.

In Chapter 5.0, concerns that are highlighted on the interface between regular stabilization programs and special assistance are discussed. This includes, among other issues whether or not SCGP assistance should have accounted for regular stabilization and how should SCGP be phased out.

In Chapter 6.0, assessment criteria on the political, economic and administrative fronts that are applicable to stabilization in the grains sector are outlined. These criteria are used in Chapter 7.0 to assess the strengths and weaknesses of WGSA, ASA and SCGP.

Possible programming modifications to ASA and WGSA are discussed in Chapter 8.0. These modifications account for the potential roles of special assistance.

Chapter 9.0 focuses on moving towards the optimal balance between regular stabilization programs and special assistance programs. A suggestion movement on stabilization programs is offered.

2.0 THE ROLE AND RATIONALE FOR SPECIAL ASSISTANCE

Regular stabilization programs are designed to even out the fluctuations of an irregular marketplace, to put more stability and security into the incomes of qualified recipients affected by these fluctuations.

Special assistance on the other hand, is specifically designed not to apply to frequently occurring instability. Rather, special assistance is in response to one-time single event needs, even if they do recur occasionally.

The role of special assistance can be viewed as intervention - generally financial - in a disaster type of situation, for example relief for flood or tornado victims, financial assistance for crop failure due to violent weather, unreasonably low grain prices, etc.

The rationale for special assistance can be more nebulous than the role, reacting as it does to single events. It can, in any given instance be the economic maintenance of a necessary industry or service, preservation of human life, political visibility, etc.

A payment such as the SCGP can have the rationale of:

1. relieves the financial stress due to the US/EEC subsidy wars;
2. prevents inappopriate resource withdrawal out of the sector;
3. allows the CWB to remain price competitive and maintain export market share;
4. indicates to the rest of the world the hardship created by the trade war; and
5. ensures visibility demonstrating that the government is responsive to the needs of Canadian farmers.

Given the fact that the roles and rationale for special assistance programs are different than for regular stabilization programs, the two should be able to live together harmoniously. This issue is addressed throughout this paper.

3.0 STABILIZATION AND INCOME SUPPORT PROGRAMMING IN THE GRAIN SECTOR

It is assumed that the reader is familiar with the following programs available to the Canadian Grain and Oilseed sector:

- Western Grain Stabilization Act (WGSA)
- Agricultural Stabilization Act (ASA)
- Special Canadian Grains Program (SCGP)
- Initial Payment Guarantee Programs (through the Canadian Wheat Board Act and the Agricultural Products Cooperative Marketing Act (APCMA))
- Cash Advance Programs through the Advance Payments for Crops Act (APCA) and the Prairie Grain Advance Payments Act (PGAPA)
- Crop Insurance Programs that are administered by provinces but cost shared between producers, provinces and Canada

These programs will be referred to through the report. The main focus of this report is on the first three, and in particular, the relationship between WGSA and ASA with SCGP.

4.0 STABILIZATION PROGRAMS IN CONTEXT

Discussions of Canadian stabilization programs are often taken out of context with respect to price support programs in the U.S. and E.E.C. A context is also required between regular stabilization and special assistance. This section, therefore, provides a context for discussing these issues.

The relationship between regular stabilization and special assistance programs requires definition of some concepts because both formats can be closely interrelated. The lexicon used here involves the terms:

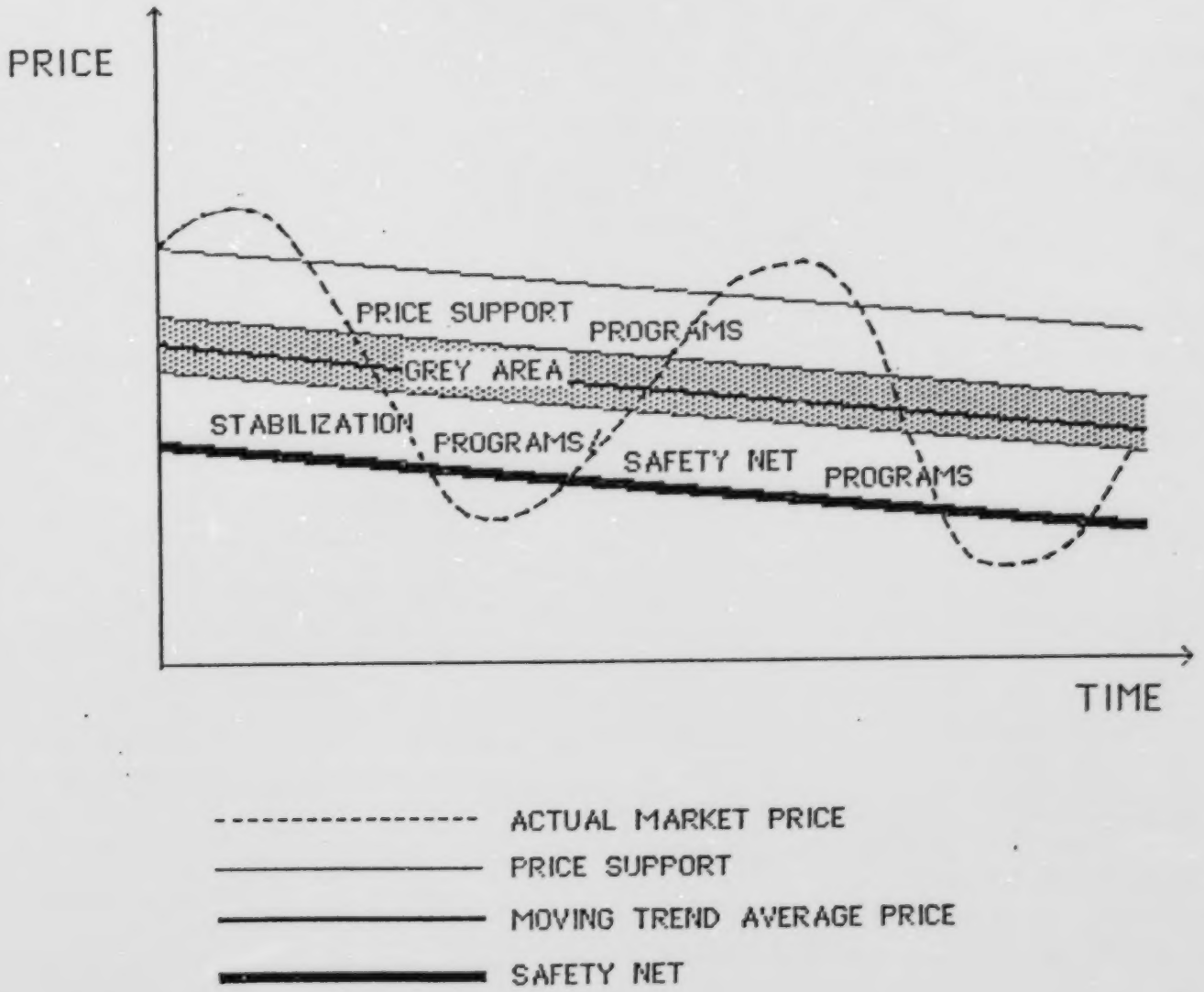
- safety net,
- price supports,
- stabilization,
- compensation,
- adjustment assistance,
- trade distortion, and
- production neutrality.

4.1 SAFETY NET

Discussions in most Canadian sectors generally refer to "safety net" programming. The U.I.C. program is a safety net, as it provides for the necessities of living until a new job is found. In agriculture, a safety net program provides a floor to the market to allow the average producer in the sector to survive a poor year and still be in business the next year. The relationship between safety net and other concepts is illustrated in Figure 4.1. As shown, the safety net provides for a floor in the market significantly below the moving trend in average prices.

A pragmatic measure of the safety net can be per unit cash costs of production. In general, a producer can maintain his resource position when cash costs are covered. However, when returns are at the safety net for successive years, then compensation may be needed because sustainability cannot be achieved at this level.

FIGURE 4.1 DEPICTION OF STABILIZATION CONCEPTS



Initial payment programs can be viewed as a form of safety net program since the price guarantee is established at around 80 percent of the expected market price.

The objectives of stabilization programs are such that they can usually be classified and argued as safety net programs. This designation is important in a trade context, as discussed in Section 4.6.

4.2 PRICE SUPPORTS

If a market price is boosted above the long term trend, then this is labelled as a price support. In particular, the supported price can range from the gray zone to anywhere above (see Figure 4.1). The greater the divergence above this gray zone, the higher in probabilistic sense that it will promote production and result in trade distortions. A price support that is trade distorting can theoretically be below the trend price level (i.e. the debate concerning the gray zone).

The U.S. target price program and the E.E.C. intervention/threshold price system are both classic cases of price support programs. In domestic (as opposed to international) terms, supply management programs can be labelled as price support systems.

4.3 STABILIZATION PROGRAMS AND STABILIZATION PAYMENTS

The concept of stabilization is substantially different from the concept of price supports. Stabilization connotes an image of stabilizing and/or moderating fluctuations in market prices. That is, the stabilized price adjusts with the moving trend in market prices, and typically is below the moving trend market price. In this context, they can be labelled as safety net programs.

Price supports convey a significantly different image, one where the market price is supported above the long term trend (see Figure 4.1). Price support programs, therefore, are at the other end of the spectrum from safety net programs.

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4.4 COMPENSATION

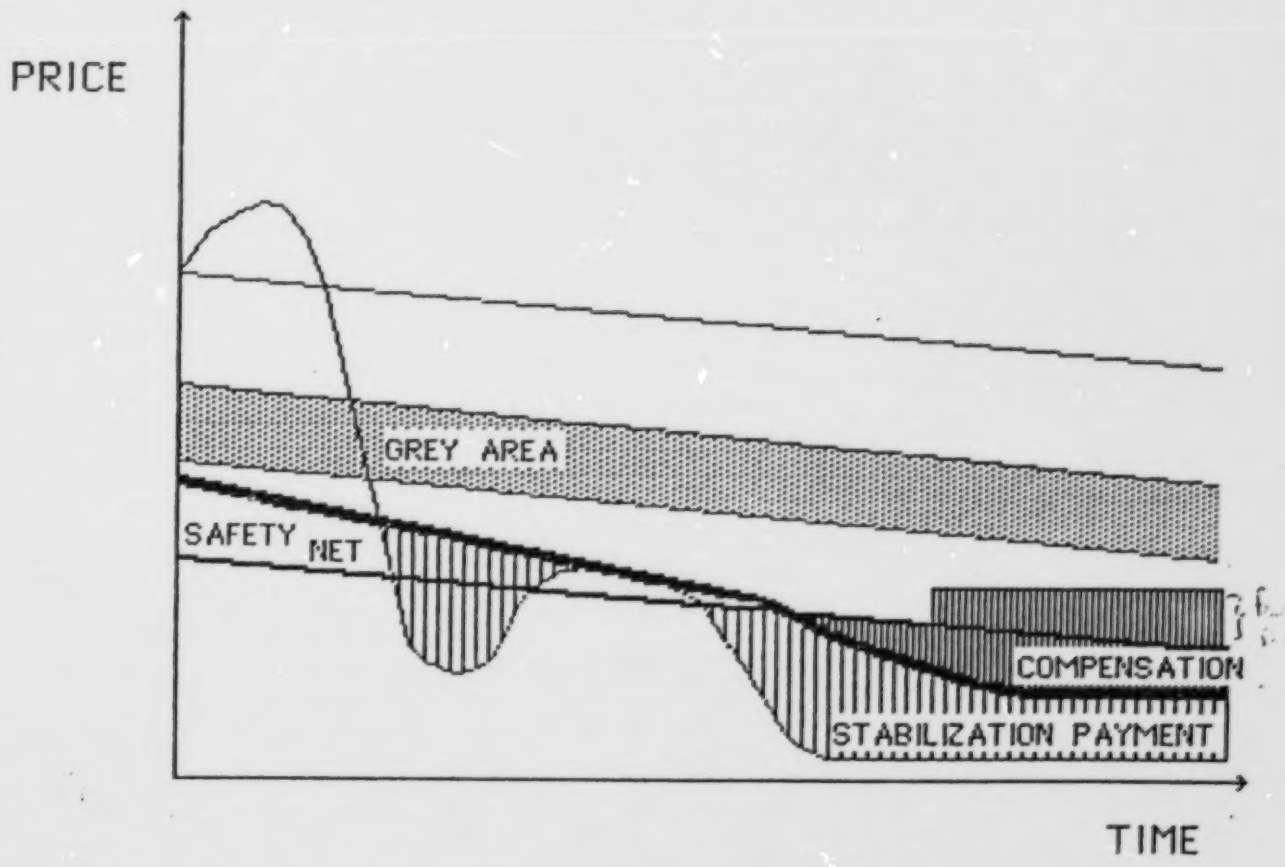
The 1986 special assistance program of SCGP should be viewed as a compensation program. Compensation, if required (which is addressed elsewhere), with the SCGP is in response to the radical change in U.S. farm policy of driving prices down by over 30 percent through export subsidies, production subsidies, dropping the loan rate (the loan rate is likely a stabilization/safety net price), while maintaining high price supports (the target price). A payment such as SCGP relieves the financial stress of the above foreign policy. The compensation payment also prevents unnecessary overwithdrawal of resources out of agriculture.

The relationship between compensation payments, stabilization payments, and the safety net is illustrated in Figure 4.2. Precisely, compensation only fills the void when the stabilization price falls below the safety net level. That is, a compensatory program ensures the safety net is provided to its' full extent.

The safety net may increase above the cash cost level, when total returns have not significantly exceeded cash costs for a period of time. This occurs due to the increased debt and financial burden that occurs when only cash costs are covered over successive years. This safety net increase is shown in Figure 4.2. However, the safety net should not enter the gray zone.

The related issue of whether the stabilized price for 1986 was above or below the safety net is touched on (Section 5.0). If so, the compensation was premature and the total returns could result in market price, plus stabilization and compensation payments being above the trend price. Furthermore, when the above occurs, arguments about SCGP getting into the realm of support prices, trade distortion, and non-production neutrality are difficult to refute.

FIGURE 4.2 COMPENSATION, STABILIZATION & SAFETY NETS



---------- ACTUAL MARKET PRICE

———— PRICE SUPPORT

———— SAFETY NET ≡ CASH COSTS

———— STABILIZATION PRICE -

Many forms of compensation programs have been made available in addition to the SCGP. For example, compensation was provided by Canada to a Quebec hog producer when his hog barn and the hogs were destroyed in a fire. Even though the animals were fully covered through insurance, additional compensation was provided. This occurred as private insurance paid the market price to the producer, not the higher stabilized price in that period. Thus compensation (outside of stabilization since it was not applicable) was provided. It appears that the intent of this compensation payment was to provide the producer a higher safety net than that which insurance alone provided.

Another example relates to storm assistance paid as a result of the 1985 tornado that swept through parts of Ontario. This program provided compensation above that provided by private insurance companies which paid up to the insured value. If the assessed market value was above the insured value the Central Ontario Disaster Relief Program compensated up to 90% of the difference between these two values. Furthermore, FCC administered a storm damage program that paid up to 35% of the difference between replacement cost and assessed market value, if replacement cost was above the assessed value.

Two issues emerge from these examples. The one is that government (and the executive in particular) may end up providing compensation above the so called "safety net". This is essentially political responsiveness and visibility at work. The second issue is that, unfortunately, it may be sending a signal to some producers not to have adequate and prudent insurance protection, since government does respond to these catastrophic events. This will be addressed later.

4.5 ADJUSTMENT ASSISTANCE

Adjustment assistance programs are designed to assist producers with a new market environment by (a) assisting in taking resources out of agriculture, or (b) making current resources more productive. In this context adjustment assistance programs are not trade distorting and in

fact work toward international and national objectives on agriculture trade. This is in contrast to compensation programs which at best keep resources that already exist still in agriculture, and at worst (if inappropriately designed) provide production incentives. The concept of adjustment assistance and compensation is discussed in a following section on expectations for the grain markets and programming (Section 5.3).

4.6 TRADE DISTORTING PROGRAMS

Canada's position at the GATT agricultural trade negotiation is that subsidy payments to agriculture can be expected and as a consequence member countrys' agricultural programs should minimize trade distortions. That is, they should attempt to achieve trade volumes and prices that would occur in a non-government intervening environment.

In this context, Canada's safety net programs are significantly more palatable than U.S. and E.E.C. price support/export subsidy productions which are clear trade distorters. The Canadian Import Tribunal ruled that the U.S. corn program (with a combination of high price supports and acreage retirement) and its' resulting subsidies was injurious to price. The resulting trade distortion is a relative concept since a safety net program by itself can promote more production through (1) the impact of reducing risk on production, and (2) the somewhat higher average price because of the safety-net feature.

The important feature is that the programming combination of stabilization payments plus compensatory payments should be designed to leave no impression that they singly, or in combination, are trade distorting.

Decoupling is also entering the jargon, where this term implies that payments to producers are independent of production and/or the payments do not influence production decisions. A program that meets this decoupling concept is essentially one that is not trade distorting.

4.7 PRODUCTION NEUTRALITY

Production neutrality is in the same camp as the decoupling concept, which essentially states that stabilization programs in themselves do not stimulate production. If they fit this criterion, they are not trade distorting.

The (possibly former) Two Price Wheat regulation is a possible candidate for a production neutral program. This is because wheat producers are paid the higher domestic price on only part of their production, in most cases this is less than 10% of production.

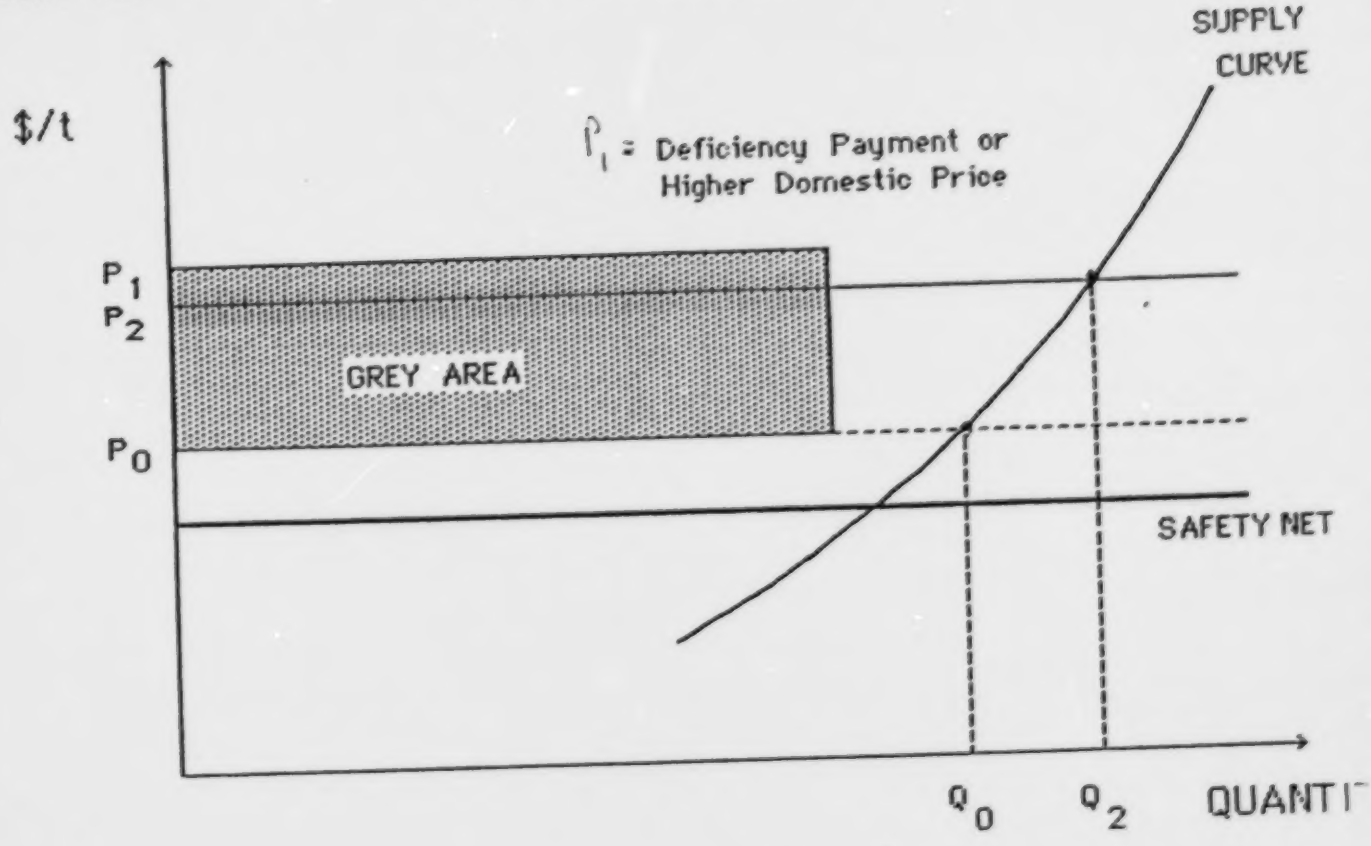
However, as shown in Figure 4.3, for the program to be truly production neutral, the price received on the next to last (i.e. marginal) unit of wheat should be the world price (P_e) or at least at the safety net level. For this to occur, two things are required. First the program must not spread the higher returns over all wheat sold, as is currently the case through pooling. Second, and most important, individual producers must use these economists' marginal concepts and make production decisions based only on the non-domestic price. It is doubtful whether producers would not merely average the prices received (P_2 in Figure 4.3) and respond to these decisions and produce at Q_2. This would not be production neutral, and if significant, could be trade distorting. However, if both conditions were met, then the payments on the first units of production could exceed the referred to gray area (i.e. at or above moving trend average prices).

The supply curve in Figure 4.3 also shows that production neutrality is a relative concept. For example, if the market price in one year is below the safety net, the safety net payment results in more production. This pales in comparison to the production that occurs with prices supported at P_1 or P_2 in the figure.

Production neutrality is also used in the context of whether or not grain produced and fed on the same farm to livestock should receive compensatory and/or stabilization payments. That is, if non-marketed

FIGURE 4.3

PRODUCTION NEUTRALITY



---------- CURRENT MARKET PRICE P_0

———— BLENDED (POOLED) PRICE P_2

———— SAFETY NET

grain were not given either or both of these payments, would it provide incentives to produce for markets and not to feed it to livestock on-farm. To the degree it does, it is not production neutral. This issue also will re-surface.

5.0 SPECIAL CONCERNS

Many concerns and policy issues have arisen out of both the need for special assistance and the resulting implementation of the SCGP. These concerns are discussed in this section, particularly as they relate to the issue of the interface between regular stabilization and special assistance.

5.1 SPECIAL ASSISTANCE -- COMPENSATION PAYMENTS CALCULATED BEFORE OR AFTER STABILIZATION PAYMENTS

The SCGP provided a compensation payment to each of the eligible grains based on the degree of injury. 'Degree of injury' was a combination of the drop in the U.S. loan rate and the expected fall in 1986/87 prices relative to 1985/86. The resulting assistance rates, on a per tonne basis, had no direct relation to likely stabilization payments.

The 1986/87 compensation rates were:

GRAIN	$/t
Wheat	18
Oats	12
Barley	13
Rye	9
Corn	14
Canola	22
Soybeans	7
Flax	20
Sunflowers	20

The regular stabilization payments for the 1986 crop year were significant. Under the WGSA, the per eligible tonne pay-out was just over $48/tonne and under ASA wheat received $25.13/tonne, corn $29.29/tonne and soybeans $11.40 per tonne. Once these payments are accounted for, the stabilized price for some commodities may indeed be above the safety net level.

Independent of these payments, given the objectives and design of regular stabilization, the compensation should be based on a net concept of injury (i.e. after the impact of regular programming). The related issue of eligibility by non-WGSA participants is addressed below.

The total returns to wheat, corn and barley for 1984 and 1986 are shown in Figures 5.1, 5.2 and 5.3. Using cash costs for wheat at $150/t and $100/t for corn and barley, these figures show that the stabilized price was well above cash costs of production. Thus, the compensation payment on some crops could have been reduced, or even may not have been needed for the 1986 year. This is not to say that it may not be needed for the 1987 or 1988 crops if the stabilized price starts to ratchet below the safety net level.

Compensation payments that account for regular programs are also fairer when the regional nature of WGSA and ASA is considered. A wheat producer in Ontario received a regular stabilization payment of $25.13 in 1986/87 while his western counterpart obtained over $48.00 per tonne. This example highlights the fact that SCGP could be fairer if payments were based on "net injury". Politically speaking, however, such an approach would have resulted in somewhat more of the $1 billion payment going to eastern Canada.

In another context, when promoting equity between producers of crops and production neutrality among crops (e.g., corn and soybeans), the level of compensation payments when made on a per tonne basis should be calculated after the influence of regular stabilization payments. By doing so, historic price relationships can be maintained to minimize the effect of special assistance on cropping and planting decisions.

In a related matter, the timing of SCGP provided needed cash flow to producers in the spring. One outcome is that regular stabilization should continue to provide interim payments to maintain needed cash flow.

5.2 ELIGIBILITY AND NON-WGSA PARTICIPANTS

Non-participants in regular stabilization programs should be eligible for special assistance compensation, particularly when this assistance is calculated as "net injury" (i.e. after the influence of regular stabilization). This preserves the universality of special assistance, and treats producers who made a business decision not to participate in statutory programs in a fair and just manner.[15] Their compensation is only that level needed which regular programs could not offset.

As a corollary to the above argument, by not indicating that compensation is over and above regular stabilization, then the incentive exists, however small, to not participate in regular programs.

5.3 WAS A 1986/87 SCGP NEEDED?

Defining the safety net as 120 percent of cash costs of production, which for barley and corn are around $100/tonne, and wheat at $150/tonne, (1) Figures 5.1, 5.2 and 5.3 show that on the basis of the level of regular stabilization assistance, and (2) the total returns relative to the 1984/85 crop, a per tonne compensation payment may not have been needed for the 1986 crop. In the case of wheat, the WGSA stabilized price was $178/tonne which is $2/t short of 120 percent of the $150/t cash costs.

This was not to say that in 1987, the payment is not needed as the stabilized price is reduced through the five-year average mechanism. As well, if a payment was required for other reasons, a more production neutral compensation payment would have been preferable. That is, equivalent compensation to all producers on a non-production basis, possibly on a percent of an historic area average, with productivity adjustments.

5.4 EXPECTATIONS ON MARKET ENVIRONMENT AND THE FORM OF SPECIAL ASSISTANCE

One's view of the future could radically alter the form of future special assistance programs. If the view is taken that the current market situation is temporary and prices will return to at least 1984/85 levels (before the U.S. farm bill influence was factored into the market) then continued special assistance could be in the form of compensation that brings total returns above the safety net.

Alternatively, if the prevalent view is that current grain prices (or within 120% of current prices) are the new reality, then compensation payments are not in order. Rather adjustment assistance should be the type of special assistance program.

The reasoning for these statements is shown in Figure 5.4. If prices are expected to improve (i.e. we are experiencing a temporary dip in the market), then the safety net level need not be lowered and compensatory payments are in order.

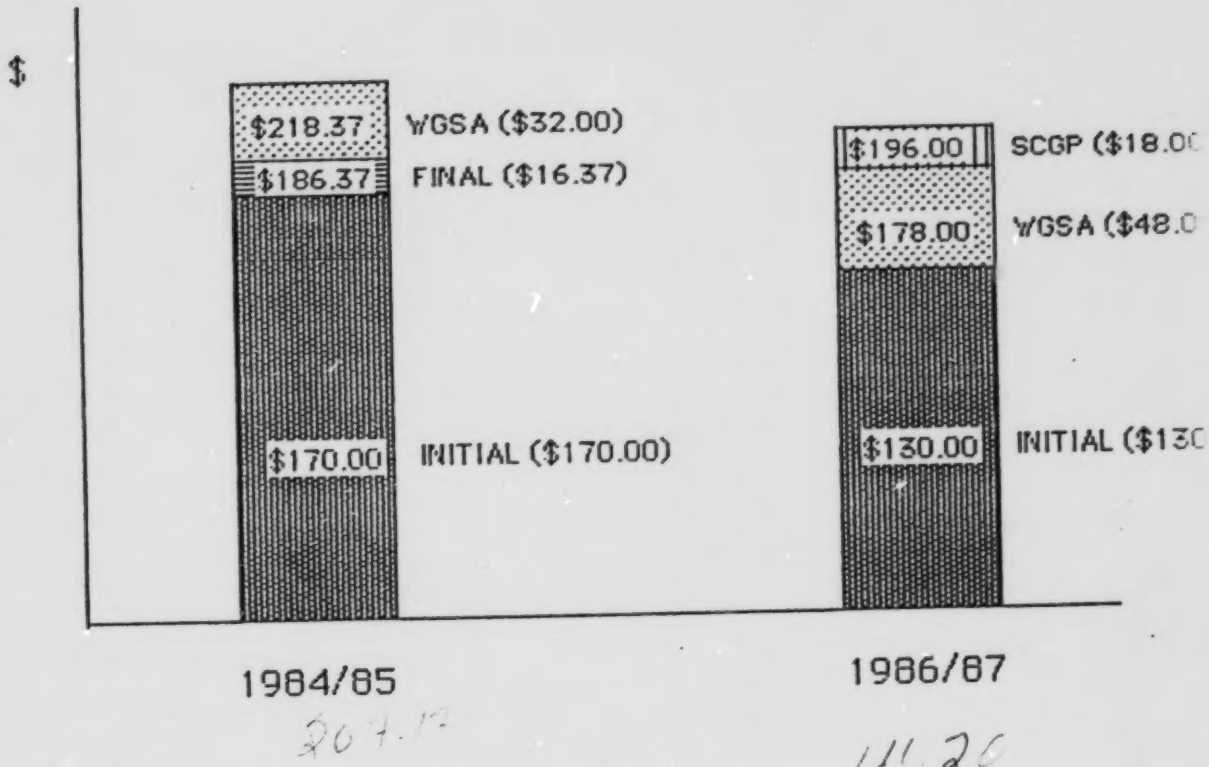
Alternatively, if significant price improvement is not expected, then the safety net must be gradually lowered to below this new price reality. If not, then capitalization of program benefits would occur and Canadian competitiveness would suffer. In this situation, the special assistance should be in the form of adjustment programs to assist producers in removing less productive and higher cost resources. As well, the adjustment assistance should help increase sectoral productivity and lower costs of providing product to market.

5.5 WHEN AND HOW TO SUNSET SPECIAL ASSISTANCE

A particular problem for SCGP is how and when the program sunsets. The $1 billion was not paid out on an objective measure (such as the formulae in WGSA and ASA) and as a result, a formula is not in place which can automatically stop payments. This issue of sunset is essentially answered when objectives are clearly enunciated, and they are measured and reflected in a formula. These are discussed below.

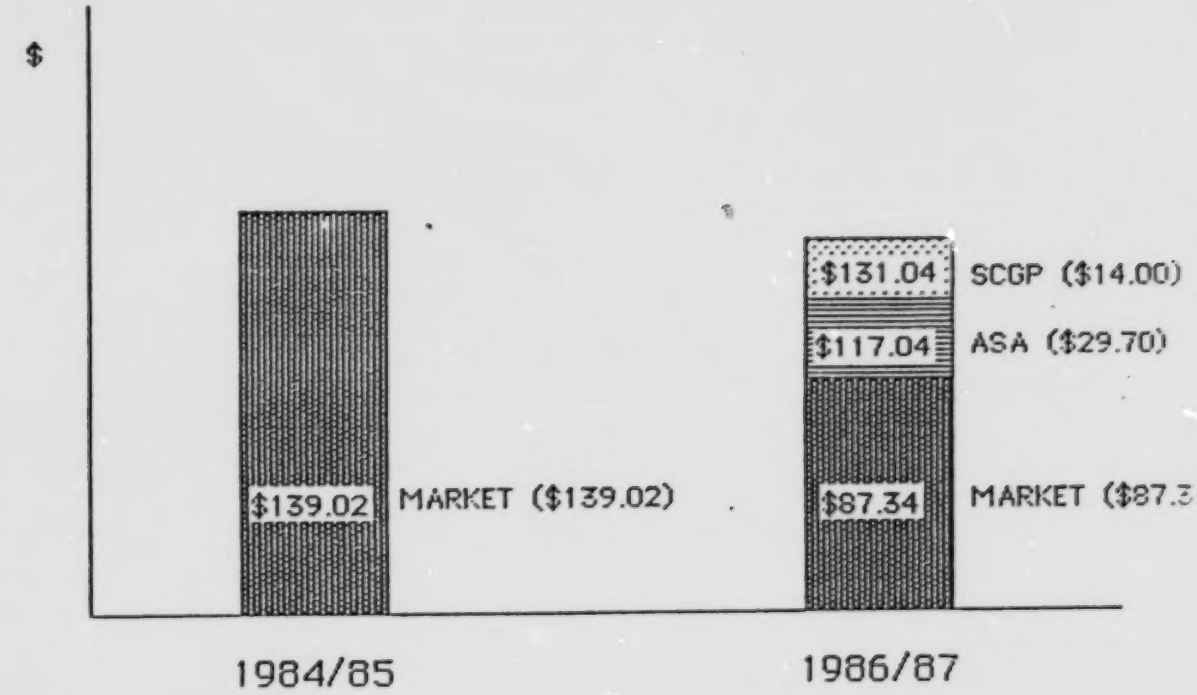
Figure 5.1

TOTAL RETURNS IN CROP YEAR 1984 AND 1986
(MARKET PLUS TRANSFERS) FOR WHEAT [1]



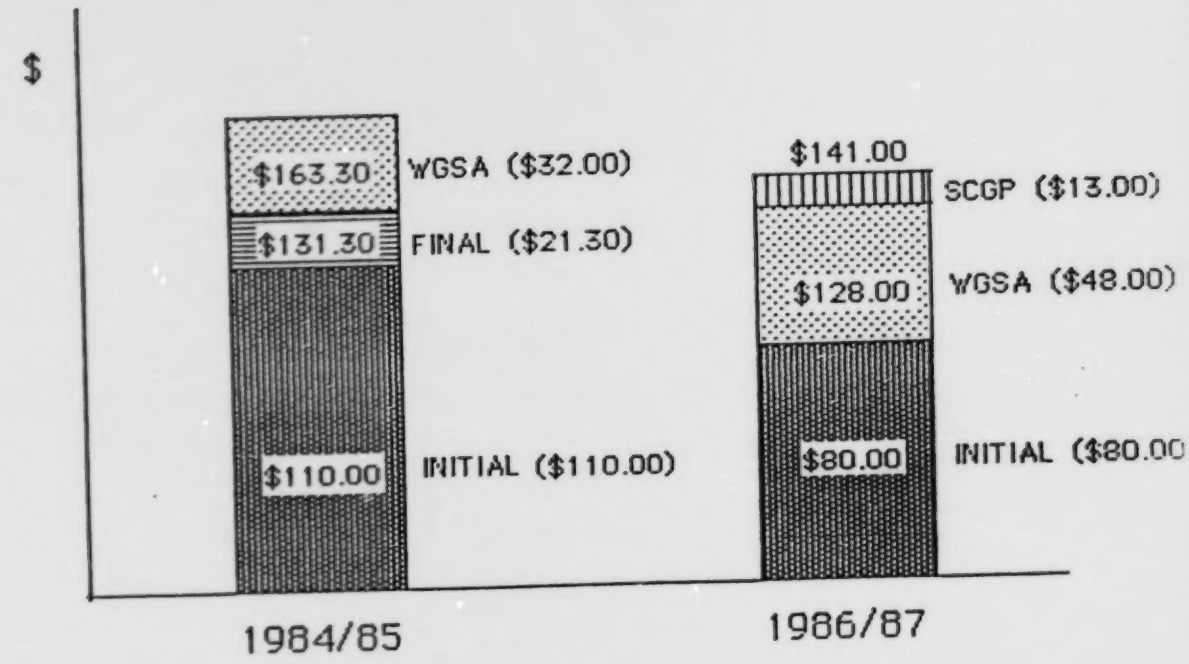
1. Per Eligible Tonne

Figure 5.2 TOTAL RETURNS IN CROP YEAR 1984 AND 1986 (MARKET PLUS TRANSFERS) FOR CORN [1]



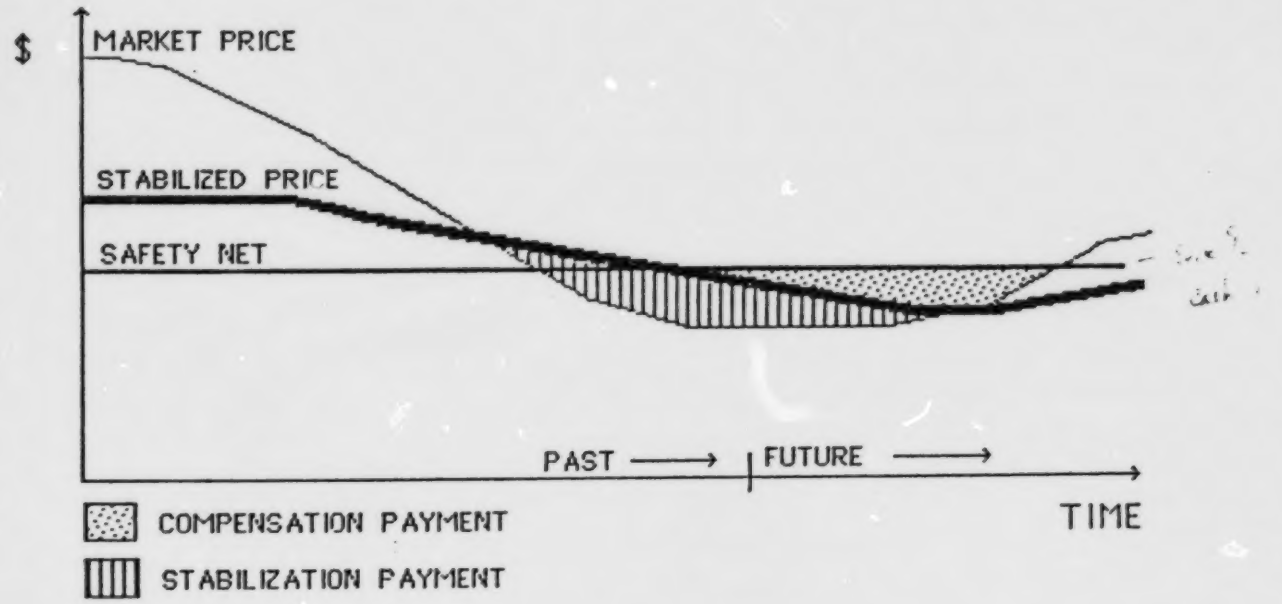
1. Per Eligible Tonne

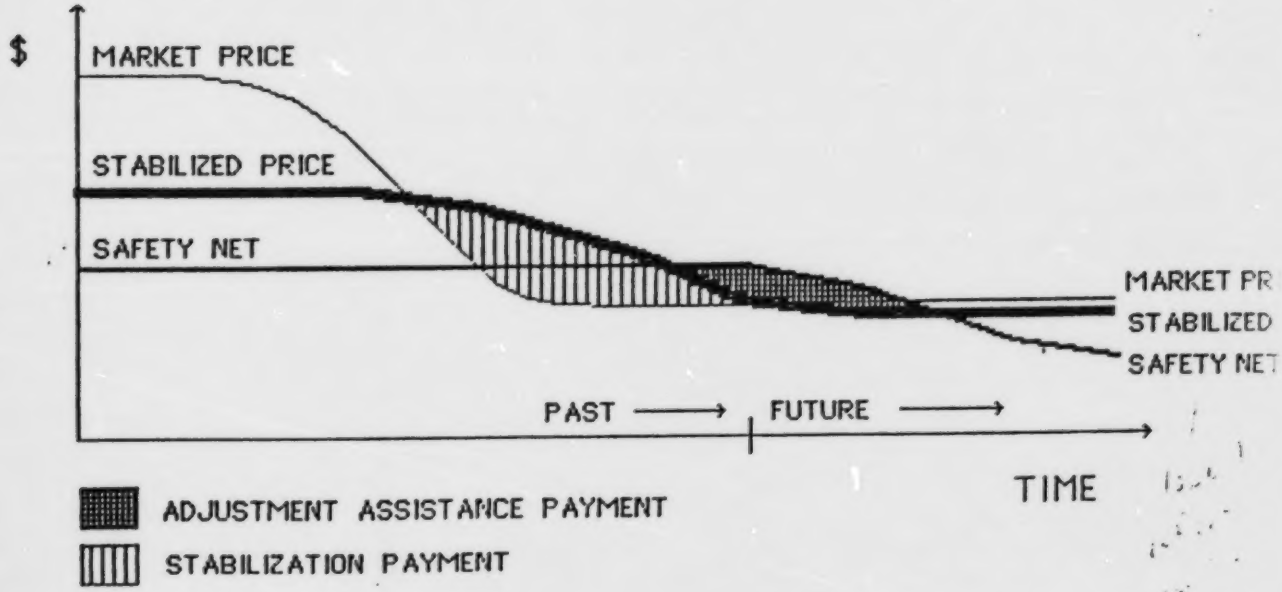
Figure 5.3 TOTAL RETURNS IN CROP YEAR 1984 AND 1986 (MARKET PLUS TRANSFERS) FOR BARLEY [1]



1. Per Eligible Tonne

FIGURE 5.4 THE COUSINS OF COMPENSATION AND ADJUSTMENT ASSISTANCE





5.6 PROGRAM OBJECTIVES AND THEIR MEASUREMENT

The objectives of special assistance have to be clearly defined and measured, for example, to ensure at least the cash costs of production plus a margin, or to guarantee producers a percentage of an historic price base.

Once program objectives are tightly defined and measured, then it is obvious to all participants how the program will be sunset, and under what conditions.

5.7 COMPENSATION AND/OR ASSISTANCE PAYMENTS TIED TO A FORMULA

A visible and a bureaucratic non-discretionary formula will achieve many objectives. Firstly, it will provide a signal on the amount of support. Second, it will enable clear measurement when a compensation payment is needed to supplement a stabilization payment. Third it will automatically sunset the program.

The formula could be designed where it automatically provides adjustment assistance if market prices do not improve, i.e. if we are in a new reality.

In a related manner, a payment formula will substantially reduce the cost to farm and commodity organizations of lobbying government for continued compensation and the uniqueness of their commodity and/or region. Lobbying effort is not required if a clear and visible formula forms the basis for compensation payments. With producers not requiring a lobbying effort, then government also requires fewer resources to attend to the lobbying effort.

The down side of this formula approach is that politicians would not be as visible and responsive since a program of this nature does not require ministerial discretion. Also, if the formula is not market sensitive, then capitalization could occur.

5.8 PROGRAM MERGING WHEN A FORMULA IS USED

From many perspectives, an SCGP compensation payment suggests that regular stabilization programs are inadequate. That is, there still is net injury. This will become more apparent and real as ASA and WGSA support winds down due to lower prices. Furthermore, measuring the objective for SCGP and basing payments on a formula can logically lead to the conclusion that only one program is needed. That is, a merging of special assistance into regular stabilization programs.

Taking such an approach, however, is based on whether or not the objectives of SCGP and ASA/WGSA are similar and/or can be similar. As an example, if the objective of SCGP is to alleviate financial stress due to low prices, then this may be at odds with stabilization programs that are designed only to stabilize price based on a moving average of prices.

In another situation, if the objective of both the regular stabilization and the special assistance program is to ensure returns at least equal cash costs, then the programs can be merged. Moreover, this indicates that the regular program did not adequately fulfill its objective.

Programming flexibility may suggest that special assistance and regular stabilization should not be merged. This is particularly acute when the large unknown is whether special assistance should be in the form of compensation, or in the form of adjustment assistance.

5.9 SPECIAL ASSISTANCE - WHO SHOULD PAY?

When special assistance is required and/or regular stabilization programs are designed to provide protection from large price declines, an outstanding issue is who should pay. To date, the federal government has been the sole contributor to SCGP and, as well, Canada has recently reduced the deficit of the WGSA fund by $750 million.

A context for who should pay for special assistance can be found in the insurance industry. (Insurance and stabilization are not identical parallels, particularly since under stabilization: (1) the adverse event is all inclusive within a given time frame, if it occurs, and (2) the probability distribution for price is not as measurable as for natural events).

Writers of insurance themselves take out insurance to insure against the probabilities working against them in one year when liabilities are greater than premiums. This is referred to as re-insurance.

Re-insurance is analogous to special assistance since both are predicated on events occurring outside of expectations. Any regular insurance premium has a component that is the re-insurance premium. At issue is whether the extent of special assistance is predictable enough to calculate a realistic premium that forms part of the WGSA/ASA (tripartite) premium. Part of the answer depends on the stabilization formula. For example, with a stabilization formula based on a 90 percent of a moving price average, the premium obligation is easier to predict than one based on cash costs plus a guaranteed minimum margin (e.g. $30 per tonne). This occurs since the latter requires estimates of the covariance between cash costs and price, and information on the future trend of both.

If a component of a regular stabilization premium was set aside into a special assistance fund, the calculated premium could be too high, which would reduce uptake in regular stabilization programming. As well, with producer premiums, a visible special assistance fund would generate political pressure to prematurely pay-out the fund when healthy balances exist.

For both of the above reasons, it appears that governments should pay for special assistance when required.

This conclusion must be tempered with the fact that stabilization programs can be designed to not require special assistance. The issue

then becomes whether or not the federal government should provide a special premium contribution when the fund is in deficit (as with WGSA). Resolution of the issue depends on whether or not special assistance (re-insurance) premiums are factored into the regular premiums. If they are, then this assistance is not required. However, if they are not, then the inter-commodity equity issues arise when government provides extra premium obligations to one commodity and not another. In the extreme, a stabilization program can be put into place where premiums are less than expected pay-outs. This would be rational if there was an expectation that the federal government would pay the deficit.

An interesting parallel occurred in crop insurance in Ontario for peaches. Many peach growers do not take out crop insurance since the premiums exceed growers perception of risk. Their perception of risk is conditioned by the recent past. Premiums, however, are established on a longer historical basis to more closely reflect actual probabilities. In the peach industry, once every 10 to 15 years a major disaster occurs, and this disaster is reflected in crop insurance premiums, but not in the risk/benefit calculations of some growers. In 1986, an adverse event did occur and peach growers argued for special assistance. In this case, the Ontario government did not provide any special assistance (except for capital reconstruction) since crop insurance was available and some growers chose not to partake.

This example bears considerations since the crop insurance premium did cover the costs of adverse events. However, as it did cover the cost the premium rate was higher than the risks associated with most years. This naturally reduced participation in the program, even when the grower premium is only 50 percent of the actuarial premium. The policy issue becomes (1) whether to achieve a rate of coverage on programs and potentially resort to special assistance to pay fund deficits, or (2) whether premiums reflect known occurrences and are higher with a lower program uptake, and this increases the lobbying pressure for special assistance when adverse events do occur (but which could have been protected against).

The crop insurance example reflects risks that are even more measurable than price risks. There are too many factors that can affect price and thus stabilization premiums should be set to reflect normal variability in price. However, inter-commodity equity must be attained, possibly by having premiums directly correspond to variability in the measure being stabilized.

If and when special assistance is required, flexibility may be the operative word. Flexibility to provide another SCGP, or flexibility to write-off some fund deficits. It may be that government should be the only contributor to special assistance, particularly when it provides for visibility and responsiveness to a need.

5.10 CANADIAN COMPETITIVENESS

During this period of SCGP and its potential repeat and/or redesign, it may be prudent to reflect on a key issue: namely, will the Canadian grain sector be competitive? Secondly, will Canada's export volumes be above or below current volumes? Answering these questions may provide input into the design of any subsequent special assistance program.

6.0 ASSESSMENT CRITERIA

The assessment criteria used in discussing the stabilization and special assistance programs can be categorized into three areas: political, economic, and administrative. The criteria are summarized in Chart 6.1, and elaborated on below. They will be used in Section 7.0 of this report when WGSA, ASA and SCGP are assessed.

6.1 POLITICAL

- Support of communities and cultures, has long been the underlying purpose behind many programs, i.e. support regardless of economic optimization. All issues must be reviewed in terms of the extent to which they contribute to (or at least, do not detract from) this aim.

- Visibility, A program designed to assist people, with the natural side effect of voter satisfaction, will not achieve this side effect if it is not visible. The degree to which both recipients and non-recipients are aware of the program will be reviewed.

- Responsiveness, to a perceived need is a crucial factor in the public's satisfaction with their political bodies.

- Voter satisfaction, as a corrollary to the visibility and responsiveness criteria, is the question of satisfaction levels of various diverse groups of voters in regards to the actions of their elected bodies. This issue is always of concern when dealing within the political arena.

- International relations, becomes a criterion insofar as government response to any given situation indicates to the rest of the world it's feelings about any issue, and the degree to which Canada is being affected. This also includes Canada's participation in international institutions and compliance with such institutional codes (e.g. GATT, OECD communiques).

6.2 ECONOMICS

- Capitalization, a subsidy payment can increase the amount a producer is prepared to pay for capital assets. The benefit of a program is reduced by the amount it is capitalized since the benefit becomes a cost to new entrants and can reduce competitiveness.

- Cost to government, is an obvious economic concern, considering the desire to keep government expenses as low as reasonable.

- Maintenance of sector competitiveness, if it is desirable to keep an economic sector viable during a period of difficulty, financial assistance is often the chosen means. As well, competitiveness implies maintaining export market performance. This is achieved by a combination of natural comparative advantage (i.e. low cost of production) and government assistance (e.g. WGSA, SCGP).

- Trade relations, despite the need to achieve desired ends within the Canadian economy, programming should not irritate trading partners. Thus programs should be GATT compatible and, as well, compatible with any Canada-U.S. trade agreement.

- Production neutrality, particularly with a product which is currently considered overproduced (many grain products), financial assistance should not be an incentive to increase production.

- Interrelationships with regular programming, or the extent to which special assistance is duplicating, working at cross purposes with, or complementing regular programs.

6.3 ADMINISTRATIVE

- Equity/fairness, is the program designed in such a way as to be equitable to all affected?

- Eligibility criteria, Are the eligibility criteria for each program designed to meet its objectives?

- Transparency, or the ease with which a recipient can determine his expected payment, and understand any explanations for discrepancy in the payment received.

- Communication, or the manner, clarity, and effectiveness with which regular and special assistance programs are disseminated to potential recipients.

CHART 6.1

ASSESSMENT CRITERIA

POLITICAL	ECONOMIC	ADMINISTRATIVE
a) support of communities and cultures	f) capitalization	l) equity/ fairness
b) visibility	g) cost to government	m) eligibility criteria
c) responsiveness	h) maintenance of sector competitiveness	n) transparency
d) voter satisfaction	i) trade relations	o) communication
e) international relations	j) production neutrality	
	k) interrelationships with regular programming	

7.0 ANALYSIS OF PROGRAMS

The three programs of WGSA, ASA, and SCGP will each be assessed individually using the assessment criteria. Summaries of the results can be found on Charts 7.1, 7.2, and 7.3. Detailed analyses are presented below.

7.1 WESTERN GRAIN STABILIZATION ACT (WGSA)

7.1.1 Political Assessment

The WGSA program was designed solely to support western grain growers, and the larger prairie grain economy during cyclical times of hardship. There was no intention of it ever affecting eastern parts of the country.

WGSA has been quite visible to the grain farmers in the west. The visibility of the fund level, particularly the $1 billion surplus in 1983 and 1984, can be viewed somewhat negatively, since it helped trigger an amendment to the legislation.

WGSA was intended to respond to relatively minor cyclical swings of net cash flow around a moving average trend, and it is achieving this aim. In this sense, WGSA is responsive to the needs of recipients.

As far as voter satisfaction is concerned, the recipient farmers are quite satisfied. Over 80 percent of producers are in the program. Farmers have been given the participation option and those who decided against it, are likely dissatisfied, particularly with the restrictions on late entry. The public at large, to the extent they are aware of the program, have not expressed strong views one way or the other.

CHART 7.1

WESTERN GRAIN STABILIZATION ACT AND ASSESSMENT CRITERIA

POLITICAL	ECONOMIC	ADMINISTRATIVE
a) maintains western area entirely and the grain sector	f) somewhat capitalized market sensitive over time	l) equitable, except in comparison to ASA (producer premiums and payment limitations)
b) quite visible to farmers, sufficiently so to rest of public	g) $1.398 billion 1986-87- $47.20 per eligible tonne	m) criteria appear to meet objectives
c) responsive to small cyclical swings in market price	h) maintains western grain sector for short periods	n) sufficiently transparent
d) participants fairly satisfied	i) no trade relations issues	o) appropriately communicated
e) WGSA can be viewed positively in the international arena as a market responsive safety net	j) neutral since stabilization payments are independent of commodity choice k) similar to ASA, some exceptions	

In the international relations area, WGSA has been viewed favourably by the United States as a farm program. This is particularly true as WGSA is sensitive to market signals, in contrast to the rigid U.S. target price. WGSA can be presented internationally as a safety net program with minimal trade distorting impacts.

7.1.2 Economic Assessment

There is no doubt that the stabilizing effect of WGSA does become capitalized into asset values. However, this capitalization is market sensitive over time. Thus, capitalization should not be considered a major issue with WGSA.

The payments from WGSA do get capitalized to an extent to the degree that government share payments and account deficits exceed producer premiums over time. This capitalization is, however, market sensitive across time.

In 1986-87, total WGSA payments amounted to $1.398 billion. Of the 36.43 million tonnes of grain marketed in the year, approximately 81% of these marketings were eligible for WGSA stabilization, or 29.61 million tonnes. This works out to roughly a $47.20 stabilization payment per eligible tonne. Producers will have contributed up to one-third of the payout through premiums.

As intended, the WGSA allows the western grain sector to remain a viable enterprise during cyclical periods of reduced market prices. Therefore, it is successful in maintaining that sector's competitiveness for future periods of upswing.

No significant trade relations issues have arisen as a result of WGSA being instituted. In fact, it could be a model for a program that is not trade distorting.

WGSA can be considered production neutral in the context of the same stabilization payment being made on all eligible grains. Producers' production decisions, therefore, are likely based on maximizing

revenue/profits before the influence of stabilization is accounted for. Thus the program, on average, is likely not encouraging the production of canola over barley.

Now that WGSA is going to include a larger set of eligible crops, the program should be more neutral with respect to program/non-program crops. The program can result in extra production of all crops, but only from

(1) the stabilized price being sufficiently above safety net levels, and

(2) the general risk-reducing affect of WGSA on production.

WGSA's interface with other programming is primarily relevant in relation to the Agricultural Stabilization Act (ASA) for Eastern Canada. The primary point of contention between the two is that ASA does not have producer premiums. However, WGSA has a "richer" payment formula with 100 percent of historic cash flow being stabilized. (The provinces in Eastern Canada are also aware that WGSA provinces do not contribute premiums, thus creating another inequality when considering tripartite.)

7.1.3 Administrative Assessment

The equity and fairness criterion is an issue for WGSA in terms of it's differences to ASA in producer premiums, actuarial considerations, and payment limitations.

Eligibility criteria have not been in contention in regards to WGSA. Except for payment limitations, they appear to be conducive to the program meeting its' objectives, at least insofar as the participating farmers are concerned.

The recipient farmers have had little or no difficulty in understanding the basis of payment. Thus, WGSA is transparent.

The final criterion, that of communication, again shows no line of contention. Everyone that needs to be aware of the program appears to

be, and the public has the necessary facts available to them whenever they wish.

7.2 AGRICULTURAL STABILIZATION ACT (ASA)

7.2.1 Political Assessment

ASA covers those crops and regions that are outside the jurisdiction of WGSA. Thus, ASA can be considered a program for central and eastern Canada.

Farmers eligible for ASA do not even need to know about the existence of the program for them to receive payments if their commodity organization is making payment application. However, on the political front, politicians would like farmers to be aware of who is providing assistance, an awareness which appears to be present. The program is less visible to the public-at-large, but not to an alarming extent.

As with WGSA, the ASA program is intended to help farmers over cyclical swings in market price, and is quite responsive to that need.

Farmers are satisfied with the program, in that it addresses a need without any cost to themselves. There is growing dissatisfaction as farmer groups are becoming aware that the stabilized price is ratcheting downward. There is also dissatisfaction by producers whose crops have a designated status and thus are uncertain whether triggered assistance will be forthcoming. Significant lobbying effort can be required to obtain a payment for designated crops. To the extent that the public is aware of the program, there is no significant dissatisfaction.

There are no international relations issues for ASA at this time. It should be noted that ASA was deemed countervailable by the U.S. in the case of hogs.

CHART 7.2

AGRICULTURAL STABILIZATION ACT AND ASSESSMENT CRITERIA

POLITICAL	ECONOMIC	ADMINISTRATIVE
a) maintains eastern communities entirely	f) somewhat capitalized, market sensitive over time	l) fairness of designated status
b) is quite visible	g) $126 million 1986-87 - $25 per tonne	m) no eligibility criteria. Does meet objectives
c) responsive to small cyclical swings in market price	h) maintains sector on short term basis	n) no problem with transparency
d) voters fairly satisfied, designated status promotes uncertainty and lobbying	i) some complaints from US that stabilization payments are, in fact, production subsidies	o) appropriate communications
e) no international relations issues	j) not as production neutral as WGSA	
	k) interfaces well with WGSA, with some exceptions	

7.2.2 Economic Assessment

The capitalization issue is basically the same as for WGSA.

Stabilization payments for the 1986-87 crop year were approximately $126 million, which across all four eligible grains works out to a weighted average of roughly $25 per tonne.

ASA's long term goals of stabilization are intended to maintain the grain sector as a competitive entity until prices rise. This will work on a short-term basis (i.e. if each downward side of the cycle is short-term) but will hamper industry adjustment if the downside is a trend rather than a blip. Before ASA was amended in the mid-1970's, the stabilized price was based on 10 years of history versus the current 5 years. A ten-year formula does provide more protection against a prolonged period of low prices.

Few trade relations complaints have resulted from inception of ASA, although the international courts have agreed with the United States that Canadian 'stabilization' programs for hogs were in fact, production subsides, increasing production and thereby reducing prices.

ASA is not as production neutral as WGSA since payments are commodity specific.

ASA is the other side of the controversy with WGSA, i.e. producer premiums. Producers under ASA currently pay nothing but receive stabilization payments, whereas WGSA producers who contribute nothing, get the same (nothing) in return. This issue also affects the next criterion, fairness and equity.

7.2.3 Administrative Assessment

Fairness and equity is provided since all potential participants are eligible. Some inequities are surfacing, particularly with canola, a designated crop under ASA and canola fully eligible under WGSA. However, this is a political issue, not an administrative issue, per se.

There are no eligibility criteria, because none are necessary - everyone is eligible regardless of participation. This absence of criteria does allow the program to meet its' operational objectives of keeping the sector on its' feet in hard times.

The transparency question has not been any significant problem. Producers are able to follow and predict stabilization payments and amounts.

Communication is again not a problem. Everyone who is affected is aware of such, and the public to the extent desired by them.

7.3 SPECIAL CANADIAN GRAINS PROGRAM (SCGP)

7.3.1 Political Assessment

The SCGP program shows no favouritism among provinces, regions or otherwise. The entire country received this supplementary payment, the only difference being the distribution of various crops across the country, and their varying level of subsidy.

For visibility to be considered favourable, recipients and general public alike should feel that they are sufficiently aware of the issue to have a clear opinion on it. SCGP however, only made public select tidbits of information, leaving unclear too many details for anyone to be completely (or even sufficiently) aware to have an informed opinion. This issue also relates to the assessment criteria of transparency and communication, discussed at the end of this section.

The event which occasioned the inception of SCGP was the considerably depressed grain prices caused by the U.S.-E.E.C. subsidy/price war. Be it for economic or political reasons, the federal government perceived the need for a one-shot (two-shot) supplementary payment to maintain the grain farmers during this period. However, the manner in which the fund was administered rendered the program not particularly responsive to that specific need, in that payments to individual farmers were not

based on individual needs, merely on across-the-board payment. It can be argued perhaps that this non-individual basis makes the program more fair and equitable to all than if it were discriminatory in its payments.

The program was possibly over responsive on the 1986 crop. This may not be the case for the 1987 crop. For those producers in financial difficulty, the program was not responsive enough.

Voter satisfaction is a very large issue for SCGP. The farmers who needed the assistance felt it was not enough - particularly with the $25,000 cap on payments. Farmers who were not in serious need of the assistance felt it was nice, although not strictly necessary, plus these are a definite minority percentage of total Canadian voters. The public-at-large were generally only aware of the fanfared "$1 billion payment" with no information on how this would benefit them as a consumer, or a breakdown of dollar payments to individual farmers. Therefore, the voting public is seeing their tax dollars going to additional subsidies to farmers who already are receiving stabilization payments, and the public is not very satisfied. This issue is also particularly relevant to the communication criterion, discussed at the end of this section.

In terms of its' international position, Canada is stating to her trade partners that the U.S.-E.E.C subsidy/price war is hurting Canadian producers, and that the hurt is severe enough to require government intervention.

7.3.2 Economic Assessment

The ad hoc nature of the program reduces the potential of capitalization. The payments were intended to ease operating cash flows and decrease costs of financing the low-income period. If anything, the program likely prevented assets from declining further.

There is however, the concern that SCGP payments are being capitalized by some farmers, particularly if they expect future payments.

The 1986-87 crop year had a budget of $1 billion. When comparing this to WGSA and ASA, a per tonnage basis must be used of approximately $16.70 per tonne. (This is a very rough figure, since the payments vary between $7 and $22 per tonne for different products).

The SCGP maintained cash flow to grain producers and thus alleviated financial pressure from all but the heavily indebted. In this context, the payment retained the sector's competitiveness. The degree to which SCGP payments have been capitalized however, decreases the competitive edge of each producer. This is not a significant issue to date.

There have been no significant trade relations issues. However, since a second payment has been made and on a commodity specific basis, this program may become an obstacle at GATT negotiations.

SCGP is more production neutral than either WGSA or ASA, in that it pays on feed crops as well as commercial marketings. However, SCGP can not be considered totally production neutral when payments are commodity specific and payments do not reflect "net injury". Consequently, producers of low priced commodities can be protected twice - once through regular stabilization, and again through SCGP. This can send the wrong signal to wheat versus soybean producers, for example.

The interrelationship between SCGP and regular programming - in particular WGSA and ASA - is not well connected. Regular stabilization programs are to a large extent, duplicated, just adding more money. However, eligibility criteria are different than WGSA, in that everyone is eligible for payments regardless of participation or not in WGSA. Basis of calculation of payment also differs from regular programs by not calculating based on need, moving average trend, market price, or

any other readily observable indicator. Differing rates by commodity were calculated as a per tonne figure, based on degree of "injury" of the expected decline in the market price of that commodity.

7.3.3 Administrative Assessment

The equity and fairness question can be argued both ways - yea or nay. It is not equitable that a bail-out service was provided to producers who had opted not to participate in (and pay into) the WGSA program. On the other hand, ignoring the participation/non-participation issue of WGSA, it offers fairness to all by not discriminating against applicants. The determination of which fairness is "more fair" becomes an issue for SCGP management to consider.

It was not fair to producers of certain commodities who were adversely affected by the program decision to base assistance on gross versus net injury. This may be one of the largest equity issues with SCGP. This will become more apparent on the 1987 crop when some specialty crops will likely receive larger payments (after stabilization) than most regular grains.

The eligibility criteria included grain fed on farm, in addition to marketed grain. The 1987 program expanded assistance to some specialty crops. These changes in criteria may, in part, reflect the issue of program rationale.

Transparency has been a serious problem for SCGP. Producers did not understand the how's or why's of their payments, calculations which had no explanations accompanying the cheques. As well, many groups never received satisfactory answers to (1) assistance based on net injury payments and (2) acreage payments instead of commodity specific assistance.

Finally, the criterion touched on with both visibility and voter satisfaction -- communication. When the federal government announced the program, it did so with much fanfare and publicity - the Billion Dollar Payment to farmers. This was a dollar figure the public could

CHART 7.3

SPECIAL CANADIAN GRAINS PROGRAM AND ASSESSMENT CRITERIA

POLITICAL	ECONOMIC	ADMINISTRATIVE
a) supports all communities equally, no favouritism	f) concern payments may be capitalized (especially if expect future payments)	l) not fair in that it is a bail-out for WGSA non-participants. is fair because paid to everyone across the board. not fair since not based on net injury
b) producers and public not sufficiently aware of program details	g) $1 billion 1986-87 = $16.70 per tonne. Farmers requesting even more 1987-88	m) included a broad base of eligibility
c) possible over-responsive in 1986, and not sufficiently responsive for those in real need	h) forestalled bankruptcy in some cases. capitalization decreases competitiveness	n) highly non-transparent
d) voter satisfaction very low	i) no significant trade relations issues yet	o) poorly communicated to both recipients and public at large
e) message to grain-producing community that Canadians are being injured by US-EEC subsidy/price war	j) not production neutral commodity specific payments and not sensitive to regular stabilization	
	k) duplicates WGSA and ASA, contradicts both in some instances	

not deal with, particularly since no indication of what this translated into for individual farmers was provided or at least assimilated. The publicity campaign could have focused on what benefits the general public would receive, both short term and long term.

8.0 POSSIBLE PROGRAMMING MODIFICATIONS TO ASA/WGSA

Potential modifications to statutory stabilization programs are suggested in this section. The discussion is guided by (1) the potential choice set, (2) the need for modification, (3) the types of modification and (4) who pays.

8.1 POTENTIAL CHOICES

The potential choice set is large, with the most feasible sets still a moving target. In Figure 8.1, a potential choice set is outlined. These are discussed below.

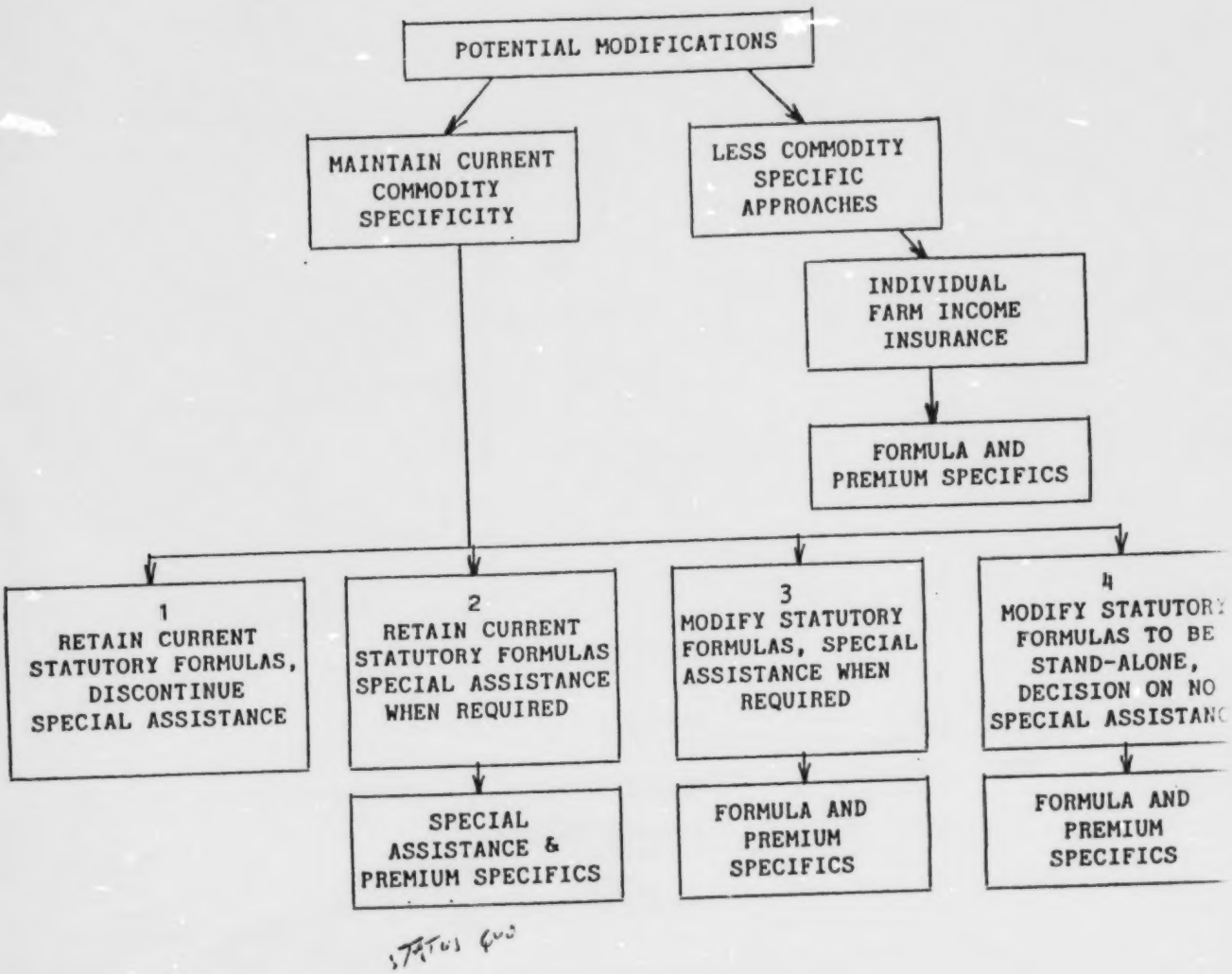
The first level of decision involves the issue of (1) maintaining commodity specific approaches to farm incomes stabilization, or (2) whether to implement approaches that are not as commodity specific.

8.1.1 Less Commodity Specific Approaches

The Individual Farm Income Insurance approach that is currently being assessed within Agriculture Canada is an example of an approach that is less commodity specific. With this approach, profitability of the total farm enterprise is stabilized on an individual farm basis. This contrasts with current programs which use aggregrate cost and return indicators on a commodity, or bundle of commodities, basis. This individual income approach has significant merit on the economic, fiscal, production neutrality, and trade policy fronts.

Notwithstanding, this approach has not been adequately assessed from a political perspective. There are two immediate negative aspects that must be overcome. One is that once the program is in place, the government losses visibility and responsiveness when commodity crises arise since the program automatically addresses the concern for each participant. Secondly, producer satisfaction may be severely diminished since an individual farm income approach could have a welfare connotation.

FIGURE 8.1 POTENTIAL PROGRAMMING MODIFICATIONS


POTENTIAL MODIFICATIONS
MAINTAIN CURRENT COMMODITY SPECIFICITY
LESS COMMODITY SPECIFIC APPROACHES
INDIVIDUAL FARM INCOME INSURANCE
FORMULA AND PREMIUM SPECIFICS
1
RETAIN CURRENT STATUTORY FORMULAS, DISCONTINUE SPECIAL ASSISTANCE
2
RETAIN CURRENT STATUTORY FORMULAS SPECIAL ASSISTANCE WHEN REQUIRED
3
MODIFY STATUTORY FORMULAS, SPECIAL ASSISTANCE WHEN REQUIRED
4
MODIFY STATUTORY FORMULAS TO BE STAND-ALONE, DECISION ON NO SPECIAL ASSISTANC
SPECIAL ASSISTANCE & PREMIUM SPECIFICS
FORMULA AND PREMIUM SPECIFICS
FORMULA AND PREMIUM SPECIFICS
STATUS QUO

Given some of the positive features of being less commodity specific, the general approach is being addressed by the government. While this approach is available to government, the timing for the political debate, the legislative ratification, and final implementation are such that it should not be considered as alternatives to WGSA/ASA in the next two to five years. After this period, an Individual Farm Income Insurance approach could likely well be a leading policy contender. As a result of this time frame it will not be given more consideration here.

8.1.2 Maintain Current Commodity Specific Approaches

The probable outcome in the near future is to retain stabilization programming that is commodity specific in nature. As highlighted in Figure 8.1, there are four main policy thrusts that can be taken with commodity specific stabilization. They are:

1. Retain current statutory formulas and discontinue special assistance (Option 1).
2. Retain current statutory formulas and adopt special assistance programs when required (the current situation) (Option 2).
3. Modify statutory formulas and adopt special assistance when required (Option 3), and
4. Modify statutory formulas to be all inclusive and specifically decide to not adopt special assistance programs (Option 4).

Relying on the first approach depends on whether or not the price stabilization formulas in ASA/WGSA are considered to be adequate. This is addressed below in the next section (8.2). The other three options are discussed in more detail in section (8.3).

The second approach is the current scenario. If statutory stabilization formulas are inadequate, the implication is that special assistance will likely continue. As conveyed in the figure, the form of special assistance can be modified with this option. Special

assistance can also be considered as stabilization fund deficit reductions and other programs such a fuel tax rebates. This option is most politically expedient since legislative changes are not required.

The third option is to modify the statutory stabilization formulas. The need and justification for modification is outlined below. With this option, special assistance can also take the form of additional subsidy payments and/or write-offs of fund deficits. This option can also cover the situation when a formula is used to phase-out the special assistance program of SCGP.

The fourth approach, of modifying formulas to cover all situations, has premium implications. It suggests that premium rates must be set to cover all situations and that stabilization formulas are responsive to all situations. Thus the premiums paid by all participants must cover all potential eventualities. Concepts of re-insurance for premium assistance when disaster occurs would not be applicable.

8.2 NEED FOR STATUTORY PROGRAM MODIFICATION

The support formulas in statutory programs (ASA/WGSA) are, definitely, in need of modification. This can be illustrated with corn under the ASA program and is graphically presented in Figure 8.2, 8.3 and 8.5. The WGSA formula illustration is shown in Figure 8.4.

The number one reason for modification is that the stabilized price is currently hovering around cash costs of production and will be below cash costs in the next year or two. As shown in Figure 8.2, the stabilized price is only $10 per tonne above cash costs. For the 1988 crop year, if higher than normal yields remain, then the stabilized price could be below cash costs. In subsequent crop years, the stabilized price will be below the defined cash costs. Thus, the stabilized price will be below the safety net. Moving the stabilized price above the safety net line can be achieved by modifying the support formula or by providing special assistance. The discussion in section 5.0 argued that having the special assistance guided by a formula suggests that the stabilization formulas in statutory programs are in themselves insufficient and should be modified.

Figure 8.2

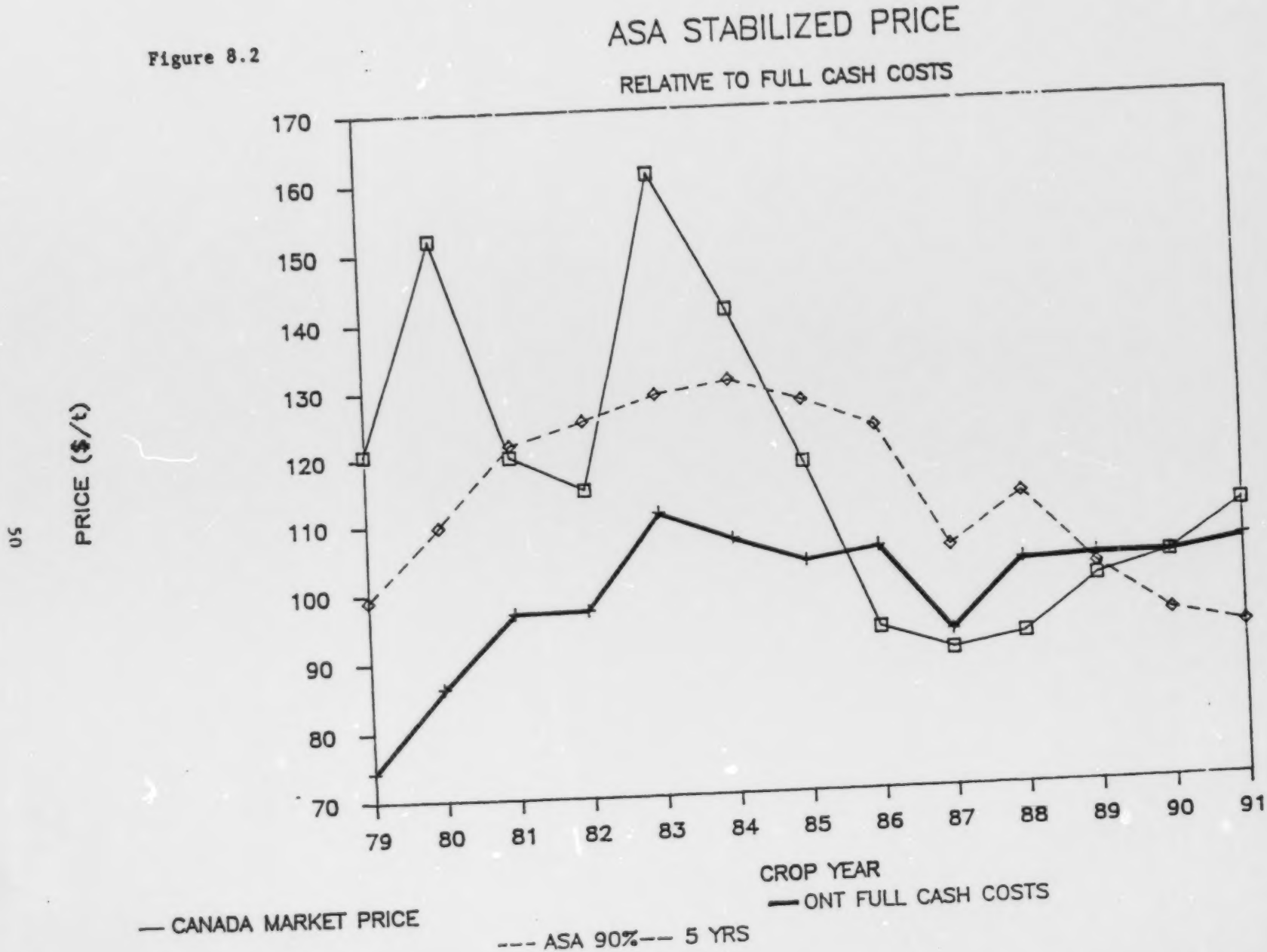

ASA STABILIZED PRICE
RELATIVE TO FULL CASH COSTS
PRICE ($/t)
170
160
150
140
130
120
110
100
90
80
70
79
80
81
82
83
84
85
86
87
88
89
90
91
CROP YEAR
— CANADA MARKET PRICE
--- ASA 90%-- 5 YRS
—ONT FULL CASH COSTS

Figure 8.3

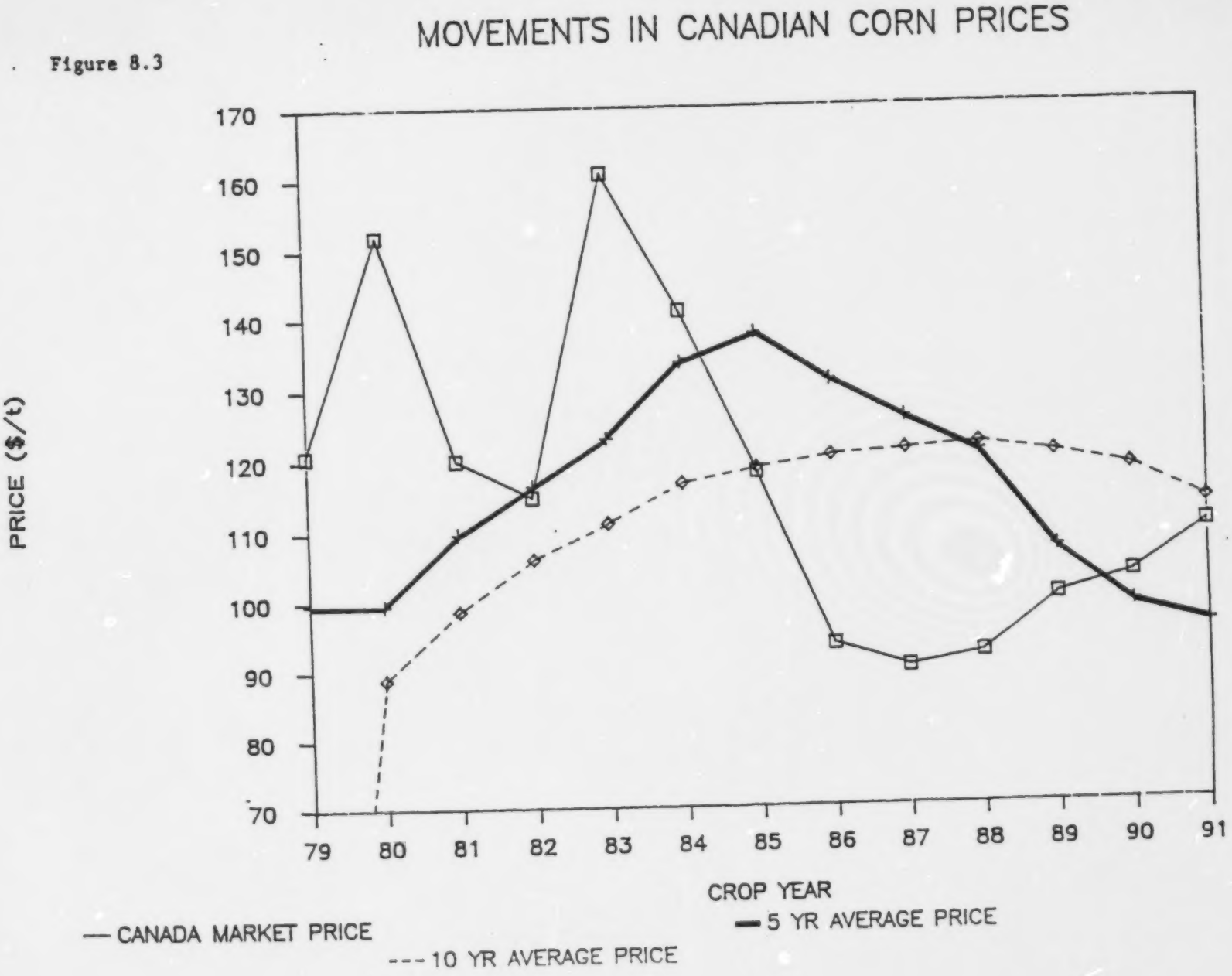

MOVEMENTS IN CANADIAN CORN PRICES
PRICE ($/t)
170
160
150
140
130
120
110
100
90
80
70
79
80
81
82
83
84
85
86
87
88
89
90
91
CROP YEAR
— CANADA MARKET PRICE
--- 10 YR AVERAGE PRICE
5 YR AVERAGE PRICE

Figure 8.4

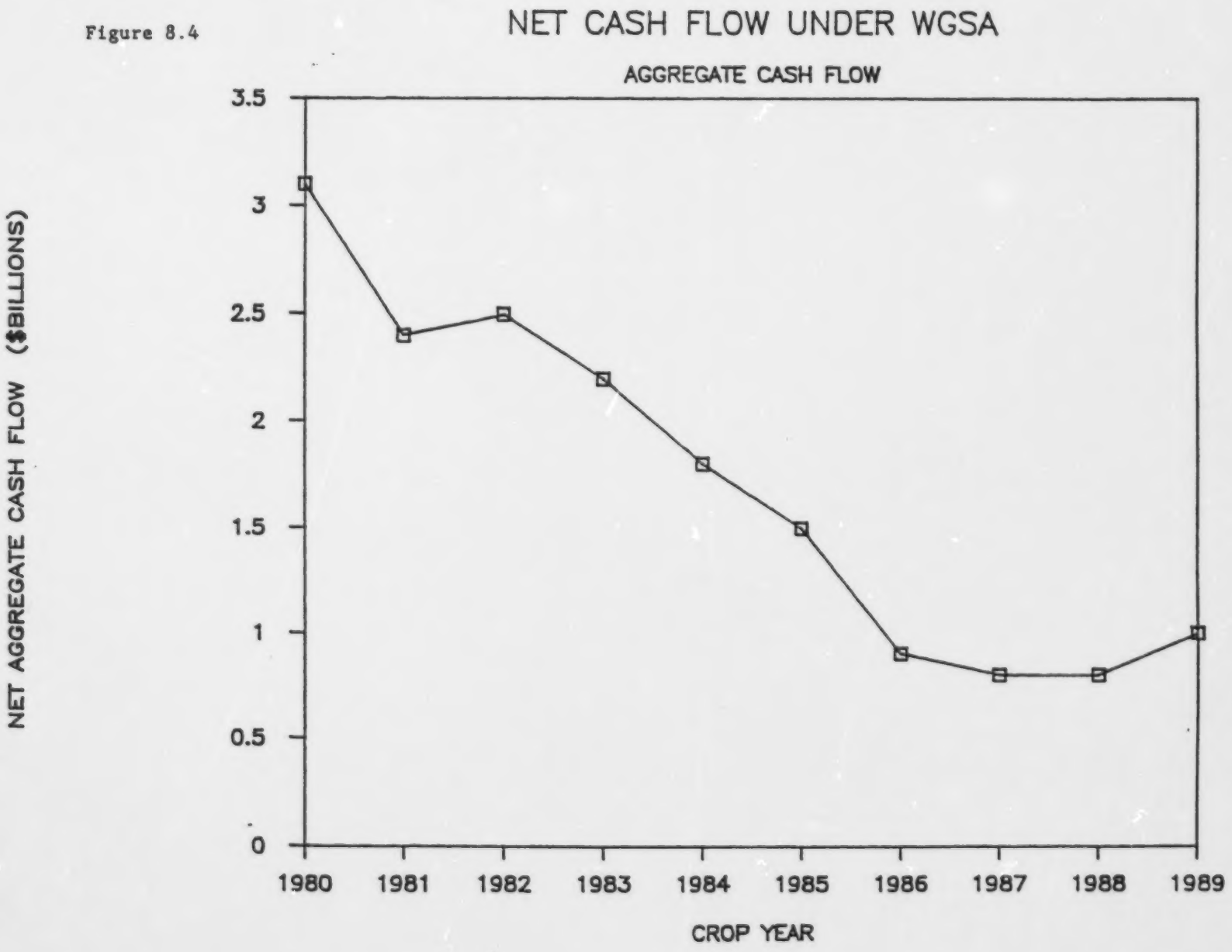
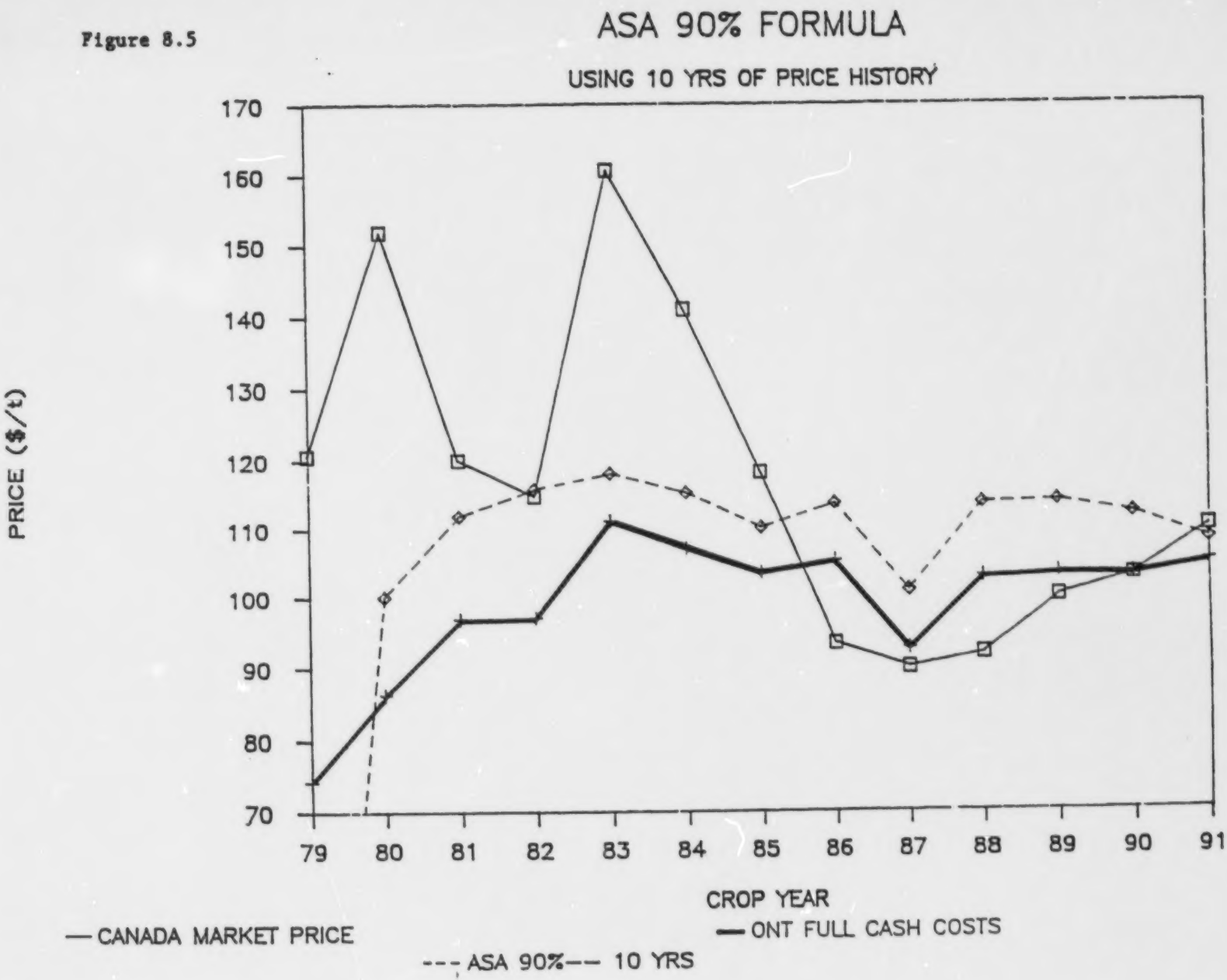

NET CASH FLOW UNDER WGSA
AGGREGATE CASH FLOW
NET AGGREGATE CASH FLOW ($BILLIONS)
3.5
3
2.5
2
1.5
1
0.5
0
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
CROP YEAR

Figure 8.5


ASA 90% FORMULA
USING 10 YRS OF PRICE HISTORY
PRICE ($/t)
170
160
150
140
130
120
110
100
90
80
70
79
80
81
82
83
84
85
86
87
88
89
90
91
CROP YEAR
— CANADA MARKET PRICE
— ONT FULL CASH COSTS
--- ASA 90%— 10 YRS

The cause of the eroding support for corn is visibly demonstrated in Figure 8.3 where the 5 year price average is dropping rapidly. The 10 year average by its nature is just peaking and will gradually decrease in the 1990's. The ASA formula, with the majority of the weight in the stabilization price coming from 90% of the 5 year average, is rapidly falling as shown in Figure 8.2.

The erosion of support under the WGSA program is illustrated in Figure 8.4. On an aggregrate prairie-wide basis, the net cash flow has slipped from over $3 billion in 1980/81 to just under a billion today. In all probability the net cash flow will fall further before it rises. The same phenomena exists when net cash flow is expressed on a per tonne basis. In this case, net cash flow has fallen by over 75 per cent from $146 per tonne in 1980 to around $30 per tonne in 1986/87. This could fall even further.

The WGSA stabilization payment is made on the basis of either the moving five-year average of the per tonne or aggregrate net cash flow. With both mechanisms in the formula, stabilization payments will drop significantly from the $1.4 billion in 1986/87 to less than $500 million in 1990, even without any dramatic price recovery.

While the ASA formula is market oriented, its shortfall is that it does not directly assure that cash costs are covered. Only the change in cash costs directly enters the formula. This could be the Achilles heel of the current ASA approach. Even the WGSA formula can potentially exhibit a negative cash flow which would also result in cash costs not being covered.

In the 1970's, the ASA Act was amended with the prior price stabilization formula which used 10 years of price history being replaced by the current one with five years of price history. The formula modification was natural for the time, since grain prices were on a general price increase in the 1970's. A 5-year moving average provided higher stabilization payments than a 10 year moving average.

While the ASA formula change was beneficial for the 1970's and the 1980's up to 1987, it will adversely affect the stabilization price from 1988 onward relative to a 10 year price average. Figure 8.5 illustrates stabilized returns when a 5 year price average is replaced by a 10 year price average in the ASA formula As shown in Figure 8.3, in the 1988 crop year, the 10 year price average starts to exceed the 5 year price average. Thus a 10 year formula provides a higher stabilized price in 1988 to at least 1992. Once the industry is on a general price rise, the advantages of a formula with 5 years of history versus 10 years will return. These same generalities are true if a margin approach is used, with the 10 year margin providing higher payments than the 5 year in the late 1980's.

Another possible need for modification of formulas in statutory programs comes from the trade policy front. With Canada proposing at the GATT to reduce and eventually eliminate all trade distorting subsidies, some of Canada's stabilization programs may need some revamping. In this regard, if increasing production neutrality implies less trade distortion, then ASA programs will have to be modified before the WGSA program, since the latter stabilizes a basket of grains, while ASA is crop specific.

Even though these trade pressures will surface, it should not be the primary reason for changing statutory programs. Rather, if a change is needed because the formulas are not meeting valid domestic objectives, then consistency with Canada's GATT position may be desirable.

8.3 TYPES OF MODIFICATION

The above discussion strongly implies that retaining current statutory formulas, without any special assistance, is not a feasible option (Option 1 in Figure 8.1).

Option two, (the current situation) should not be considered an option when special assistance is paid out (and phased out) through a formula. Using such a formula strongly suggests that statutory formulas are not

sufficient to address a measured objective. And as indicated above, current statutory programs are becoming less responsive to need and safety net concepts. Even when special assistance is defined as writing-off program deficits, this does not address the issue of formula inadequacy. Without modifying statutory programs, the proportion of assistance coming from ad hoc and special assistance programs will become excessively larger since associated formulas are not adequate from a cash flow perspective. Such a program benefit balance increases risk to producers in the area of government program uncertainty.

Only Option 3 and Option 4 remain as viable alternatives. Option 3 involves modifying the statutory formulas, but relying on special assistance when needed. Option 4 has no special assistance. Ruling out special assistance implies that premiums must pay for all liabilities. Re-insurance provisions are not available, such as fund deficit write-offs. This will be dealt with in a following section.

Potential modifications can include:

1. using 10 versus 5 years of history on prices and/or margin,
2. assure cash costs on variable cost items plus cash costs on fixed items (such as interest costs on intermediate term loans, cash land rent), and See p.54
3. separate formula calculations with payout based on the higher payment calculation.

8.3.1 Include More History in the Formula

The graphs on corn prices illustrate that a formula based on 10 years of prices and/or margins will provide higher stabilization payments when the market is near the bottom of a price cycle. This benefit is at the expense of a lower stabilized price during a rise in the price cycle. Using corn as an example, the differential in the stabilization price between 1980 and 1987 is significant when comparing the 5 and 10

year price averages in Figure 8.3. This suggests that a formula with some flexibility could be desirable. As the market moves up and down the price cycle then margins above cash costs increase, decrease, at times, disappear, and even become negative.

8.3.2 Ensuring Cash Costs Plus a Minimum Margin

The margin formulas in the WCSA uses 5 years of margin history, the hog and white bean formulas in tripartite use 5 and 7 years, respectively. There are theoretical possibilities for this rolling average margin to become negative. Returning to corn, the market has been returning less than full cash costs since the 1986/87 crop year (full cash costs include replacement costs, and exclude any land cost and management cost). A few successive years of not meeting these costs and a producer is in severe financial (and emotional) difficulty.

To rectify this inherent problem with margins based on only history, the support formulas could guarantee that cash costs as normally computed by the Agricultural Stabilization Board (ASB) are covered, plus a minimum margin. For example, the margin could be another $20 per tonne to cover cash rent and interest on machinery and equipment purchases. This minimum margin is consistent with the concept presented in section 4.0, where the safety net moves above cash when market prices remain at or below the safety net level for a succession of years. Just ensuring that the guaranteed margin is never negative would also be a step in the right direction.

8.3.3 Combine Features of Separate Formulas

This approach to formula modification provides the flexibility to allow the stabilization program to be responsive, and of course, market-oriented. As a precedent, the WCSA has two calculations (aggregrate and per tonne) with actual payment based on the higher stabilization of the calculations.

Examples of this approach given the issues outlined in this section include:

1. Cash costs plus a historic margin, where the historic margin can never be negative.
2. Cash costs plus a historic margin, with the margin at least $20 per tonne.
3. Cash costs plus an historic margin, with the margin being the greater of a 5 year and a 10 year rolling average.
4. The current ASA formula with the option of using the higher value of 10 years of price history versus the current 5-year method.

These combined formulas, plus the other modifications discussed above, are compared in Table 8.1 against the criteria of:

1. market orientation
2. ensure cash costs
3. stabilized price adversely affected by price swings

Depending on the readers' weighting of the criteria, a combination of formulas 1, 2, and 3 in table 8.1 may be the most desirable.

Production neutrality is not used as a selection criteria since the concept can be implemented with these formulas. An example may be that stabilization only applies to a base production amount for each farmer.

8.4 PREMIUMS AND WHO PAYS

One advantage of the non-tripartite portion of the ASA Act is that actuarial and fund balance considerations are not a yearly issue. In fact, the re-insurance problem does not exist since under ASA, the government has the statutory financial obligation to provide a stabilization payment to all eligible tonnes.

TABLE 8.1

COMPARISON OF FORMULA MODIFICATION

FORMULA MODIFICATIONS	MARKET ORIENTATION	ENSURE CASH COSTS	STABILIZED PRICE ADVERSELY AFFECTED BY PRICE SWINGS
1. Cash costs plus margin greater of zero or historic average	Yes	In most cases	Medium
2. Cash costs plus margin greater of $20 or historic average	In most cases	Yes	Low
3. Cash costs plus margin greater of 5 year or 10 year average	Yes	Not necessarily	Low
4. ASA - price average greater of 5 year or 10 year average	Yes	Not necessarily	Low
5. Current - ASA	Yes	Not necessarily	High on price decline
6. Current - WGSA and cash costs plus margin	Yes	Not necessarily and not commodity specific	High on price decline
7. Current - ASA and WGSA with more history	Yes	Not necessarily	High on price rises

However, in WGSA and the tripartite portion of ASA, fund balances, premium obligations, and actuarial considerations are extremely important.

In the context of options 3 and 4, the decision on whether or not special assistance, of whatever form, will continue into the future is crucial for these parts of the legislation. As modified formulas become less responsive to short-term changes in market prices, then larger financial obligations emerge when economic disasters occur. As a consequences, special assistance programs like the SCGP are not as likely to be required.

If special assistance was not a possibility, even as a fund deficit write-off (option 4), then these occurrences would have to be factored into annual producer, provincial and federal government, premium payments. Higher premium levels will (1) reduce participation by producers, and (2) reduce the willingness of provinces to contribute into tripartite schemes.

With special assistance, these formulas can have associated premiums that account for the normal price and cost movement. An example would be the current maximum 6 to 9 percent applicable to WGSA and tripartite agreements, respectively. Special assistance would come when the premiums did not cover financial obligations from disasters. This special assistance is similar to the WGSA $750 million debt write-off.

Additional special assistance (i.e. SCGP) would likely not be needed since the stabilization formulas, by themselves, would provide the cushion and safety net against price collapse, i.e. if formulas were modified to be more responsive. The special assistance needs that remain are to pay for the regular programs.

Political visibility and responsiveness are still present, albeit not to the same extent, with special assistance directed at premium reductions (option 3). The political task is to obtain and maintain the visibility before, during and after the debt reductions.

Canadian taxpayers (i.e. the Federal government) should be the only contributor to these re-insurance (special assistance) payments. this stems from:

1. the federal agricultural policy mandate,
2. the public good nature of stabilizing an industry, and
3. precedent on compensation payments.

9.0 MOVING TOWARDS THE OPTIMAL BALANCE

Optimal and optimization implies that the weightings of the political, economic, and administrative are known. As well, most optimization procedures in mathematical models impose starting points and bump into constraints as the "optima" is being discovered.

Without imposing the weightings on the various criteria, our suggestion on moving towards the optimal balance involves the following:

i) Modify the stabilization formulas in statutory programs to ensure that the resulting stabilization payments are more responsive financial and cash flow needs in the grain and oilseed sector. Such modification can include:
   a) a flexible formula which provides assistance based on cash costs plus the greater of a non-negative 5 or 10 year margin.
   b) increasing the coverage of historical margin when payouts are occurring for three or more successive years.

ii) Maintaining special assistance and at minimum providing special payments to stabilization funds when economic disasters occur. This implicitly recognizes that government is providing re-insurance or contingent liabilities and the regular premiums by participants are based on normal swings in the market.

iii) Addressing the issue of whether the past few years were a typical blip in the market, or whether the grain sector has entered a new economic environment. If the latter, then special assistance in the form of universal payments to commodities should not be considered. Rather, special assistance should take the form of adjustment assistance.

iv) Programming changes should retain the flexibility for any future modifications to become GATT compatible if signatories agree to concepts of decouplings and/or minimizing trade distorting subsidies.

SUMMARY

ROLE AND RATIONALE OF SPECIAL ASSISTANCE

Special assistance and regular programming are often expected to complement each other simultaneously, in any given situation. To do this, each must satisfy its' own role and rationale for existence. Special assistance by its' very nature takes on the intervention role, responding to one-time single event needs, compared to regular stabilization programming which is designed to even out the regular fluctuations of the market place.

STABILIZATION CONCEPTS

Several concepts are used throughout this discussion, interrelated concepts concerning stabilization. These are:

- safety net
- price supports
- stabilization
- compensation
- adjustment assistance
- trade distortion
- production neutrality

These terms must be differentiated, in order to illustrate the points made at later sections of the discussion.

SAFETY NET

A safety net is a guaranteed price providing for a certain specified minimum return. This safety net can be generally expressed in terms of cash costs.

PRICE SUPPORTS

The artificial boosting of a market price is a price support. If a stabilization program maintains the return at consistently above market price, this is more price support than safety net.

STABILIZATION PROGRAMS

Stabilization acts as an evener of market fluctuations, generally based on a moving average market price. It is important that stabilization be considered a safety net rather than having trade distorting price support tendencies, particularly where international relations are concerned.

COMPENSATION

The term compensation connotes an unusual or unexpected occurrence causing injury -- which then is compensated for. If stabilized prices fall below the safety net level, any top-up payment would be considered compensation.

ADJUSTMENT ASSISTANCE

Adjustment assistance programs are designed to help producers gradually adjust to a new market environment by either taking resources out of agriculture or making current resources more productive.

TRADE DISTORTING PROGRAMS

If a program affects either the quantity of a product available for international trade or the price of such product, the program is a trade distorting one. Such trade distortions can seriously impact on international trade relations and should be strenuously avoided.

PRODUCTION NEUTRALITY

Production neutrality means that assistance payments to producers do not stimulate production increases by producers.

CONCERNS AND POLICY ISSUES ON SPECIAL ASSISTANCE

Numerous policy issues and concerns specific to the need for and implementation of special assistance, and particularly SCGP, have arisen and become crucial to the analysis of the interface.

- **Should compensation payments be calculated before or after stabilization payments?**

SCGP provided payment based on 'degree of injury'. This degree of injury is less after stabilization payments have been factored in, but was measured prior to such stabilization. Once WGSA and ASA payments have been received, the degree of injury may not have been below the safety net level.

When promoting equity between producers and production neutrality among crops, the level of compensation (SCGP) payments should be calculated after the influence of regular stabilization payments, to minimize the effect of special assistance on cropping and planting decisions.

- **Should non-participants in regular stabilization programs be eligible for special assistance?**

The answer to this question is 'Yes', to protect the universality of special assistance, treating producers who made the business decision not to participate in a fair and just manner. The compensation should only be the same as for participants, i.e. that level which regular programs did not offset.

- **Was a 1986/87 SCGP needed?**

In 1986 stabilized prices were close to or over the safety net, if it is defined as 120% of cash costs. Compensation in this case may not have been needed for the 1986 crop.

As the 5 year moving average price falls even lower for 1987, a compensation payment was likely required for 1987 crops.

- How do expectations of the market environment influence the form of special assistance?

If the view is taken that the current market situation is temporary and prices will return to at least 1984/85 levels, then continued special assistance could be in the form of compensation that brings total returns above the safety net.

However, if the view is that current grain prices are the new reality, then adjustment assistance should take the place of compensation payments.

- When and how should special assistance be sunset?

This issue becomes a problem when no formula is in place to automatically stop payments.

- How can program objectives and their measurement assist the sunset issue?

Once program objectives are clearly defined and measured, it is obvious to all participants how and under what conditions the program will be sunset.

- Why should assistance payments be tied to a formula?

There are several reasons to tie payments to a formula including:

- providing a signal on the amount of support
- enabling clear measurement of when a payment is needed
- automatic sunset of the program
- reducing lobbying costs by producers when attempting to gain non-formula payments

The downside to the formula approach is that politicians do not appear as responsive and visible. This can be largely overcome through media campaigns outlining the benefits occurring. Also, if the formula is not market sensitive, then capitalization could occur.

- **Should special assistance be merged into regular programming?**

The answer to this is partly based on whether or not the objectives of SCGP and WGSA/ASA are congruent. Merging of the two types of programs, both with formulas, suggests that the regular programming was insufficient.

Programming flexibility may suggest that the two should not be merged, particularly when the preferred form of special assistance is unknown.

- **Who should fund the special assistance?**

To date the federal government has been the sole funder of SCGP, and has recently reduced the deficit of WGSA.

The issue also arises of premiums -- should the cost of special assistance be built into premium calculation? This would escalate premium costs to an exhorbitant level, thus probably reducing producer participation in the programs.

Thus it appears that governments should pay for special assistance when required. Such payments are similar in nature to re-insurance which offsets liabilities that are greater than premiums.

- **Does the existence of special assistance reduce Canadian competitiveness?**

This remains an issue crucial to the design of any special assistance program.

ASSESSMENT CRITERIA

To perform analysis of the interface between the three primary programs, an assessment criteria framework was developed, split into three categories: political, economic, and administrative criteria. These criteria are:

POLITICAL

- support of communities and cultures
- visibility
- responsiveness
- voter satisfaction
- international relations

ECONOMIC

- capitalization
- cost to government
- maintenance of sector competitiveness
- trade relations
- production neutrality
- interrelationships with regular programming

ADMINISTRATIVE

- equity/fairness
- eligibility criteria
- transparency
- communication

Note: In the following summary discussion only points with strong results will be mentioned.

WGSA -- RESULTS OF ASSESSMENT CRITERIA

Pros

- WGSA has been quite visible to producers
- viewed favourably by the international trade community, as a safety net program with minimal trade distorting impacts
- production neutral to a fair degree

Cons

- there is a point of contention in WGSA's interface with ASA, in that WGSA requires producer premiums, but then also provides higher stabilized payments

ASA -- RESULTS OF ASSESSMENT CRITERIA

Pros

- fairness and equity is provided, except in some designated crops

Cons

- 10 year formula would provide better support at this time than the current 5 year formula
- not completely production neutral, since payments are commodity specific

SCGP -- RESULTS OF ASSESSMENT CRITERIA

Pros

- shows no favouritism among provinces
- statement of injury, to international trade forum
- assisted in keeping farmers afloat
- more production neutral than either WGSA or ASA

Cons

- communication to public was poor
- for 1986 crop, may not have been necessary
- not responsive enough for producers in financial difficulty
- voter satisfaction low
- transparency was a serious problem

POSSIBLE PROGRAMMING MODIFICATIONS

Potential modifications can take several formats. The first dichotomy lies in maintaining commodity specific approaches to stabilization versus approaches which are not commodity specific. With the later tactic, profitability of the total farm enterprise is stabilized as a whole.

Within the commodity specific plane, there are four possible options:

1. Retain current statutory formulas and discontinue special assistance

2. Retain current statutory formulas and adopt special assistance programs when required (the current situation)

3. Modify statutory formulas and adopt special assistance when required, and

4. Modify statutory formulas to be all inclusive and specifically decide not to adopt special assistance programs.

Modification is a definite necessity for the support formulae in ASA and WCSA. The stabilized price is currently hovering around cash costs of production, and will be below cash costs in the next year or two, bringing it below safety net level. To bring the price above the safety net, either the formula can be modified or special assistance provided.

Because of the need for modification, Option 1, retaining current formulas with no special assistance, is not feasible.

Option 2, the current situation, is also not optimal, as the formulas meet the assessed needs less and less.

Option 4, only regular formula payments with no special assistance, would require exhorbitant premiums.

The only remaining Option, 3, involves modifying statutory formulas but relying on special assistance when necessary. Three modifications were considered.

1. using 10 versus 5 years of history on prices and/or margin,
2. assure cash costs on variable cost items plus cash costs on fixed items (such as interest costs on intermediate term loans, cash land rent), and
3. separate formula calculations with payout based on the higher payment calculation.

MOVING TOWARDS THE OPTIMAL BALANCE

Our suggestions on regular programs is to have built-in formula flexibility where the formula ensures a safety net to growers in situations of high costs and also in periods of prolonged low prices. We have suggested a margin concept where the greater of a non-negative 5 and 10 year margin above cash costs is employed. Moreover, to provide cash flow when it is direly needed, the percentage of margin should increase when disaster occurs - such as when producers have had to rely on stabilization payments for three or more successive years.'

Once statutory programs are modified, then the appropriate role of ad hoc special assistance can be ascertained. The main issue is whether the assistance should be to offset a short fall in statutory

programming. This approach includes a compensation payment when the stabilized price is still below a safety net concept, and, as well, the need for additional premium assistance to deficit ridden stabilization funds. This helps lighten the premium load on producers. If regular programs are considered adequate, then special assistance may still be required in the form of adjustment assistance as the grain sector adjusts to a new economic reality.